INFORMATICA CORP
Form 10-Q
May 06, 2004

# UNITED STATES SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

# Form 10-Q

(Mark One)

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the quarterly period ended March 31, 2004**
**or**

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**Commission File Number 0-25871**

# Informatica Corporation

*(Exact name of registrant as specified in its charter)*

| | |
|---|---|
| **Delaware** | **77-0333710** |
| *(State or other jurisdiction of incorporation or organization)* | *(IRS Employer Identification No.)* |
| **2100 Seaport Blvd. Redwood City, California** | **94063** |
| *(Address of principal executive offices)* | *(Zip Code)* |

**(650) 385-5000**

*(Registrant s telephone number, including area code)*

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 (the Exchange Act ) during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ No o

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes þ No o

As of April 30, 2004, there were 85,735,467 shares of the registrant s Common Stock outstanding.

**INFORMATICA CORPORATION**

**FORM 10-Q**

**For the Quarter Ended March 31, 2004**

**TABLE OF CONTENTS**


| | | Page |
|---|---|---|
| | **PART I. FINANCIAL INFORMATION** | |
| Item 1. | Condensed Consolidated Financial Statements | 2 |
| | Condensed Consolidated Balance Sheets as of March 31, 2004 and December 31, 2003 | 2 |
| | Condensed Consolidated Statements of Operations Three Months Ended March 31, 2004 and 2003 | 3 |
| | Condensed Consolidated Statements of Cash Flows Three Months Ended March 31, 2004 and 2003 | 4 |
| | Notes to Condensed Consolidated Financial Statements | 5 |
| Item 2. | Management s Discussion and Analysis of Financial Condition and Results of Operations | 14 |
| | Risk Factors | 26 |
| Item 3. | Quantitative and Qualitative Disclosures About Market Risk | 35 |
| Item 4. | Controls and Procedures | 36 |
| | **PART II. OTHER INFORMATION** | |
| Item 1. | Legal Proceedings | 37 |
| Item 6. | Exhibits and Reports on Form 8-K | 38 |
| Signature | | 39 |
| Exhibit Index | | 40 |
| EXHIBIT 31.1 | | |
| EXHIBIT 31.2 | | |
| EXHIBIT 32.1 | | |

Table of Contents

## PART I. FINANCIAL INFORMATION

**Item 1.** ***Condensed Consolidated Financial Statements***

### INFORMATICA CORPORATION

### CONDENSED CONSOLIDATED BALANCE SHEETS
**(In thousands)**

| | March 31, 2004 | December 31, 2003 |
|---|---|---|
| | (Unaudited) | |
| **ASSETS** | | |
| Current assets: | | |
| Cash and cash equivalents | $ 81,353 | $ 82,903 |
| Short-term investments | 150,658 | 140,890 |
| Accounts receivable, net of allowances of $850 and $1,269, respectively | 26,233 | 34,375 |
| Prepaid expenses and other current assets | 8,831 | 5,124 |
| Total current assets | 267,075 | 263,292 |
| Restricted cash | 12,166 | 12,166 |
| Property and equipment, net | 36,605 | 38,734 |
| Goodwill | 82,003 | 82,186 |
| Intangible assets, net | 4,736 | 5,325 |
| Other assets | 1,582 | 1,105 |
| Total assets | $404,167 | $402,808 |
| **LIABILITIES AND STOCKHOLDERS EQUITY** | | |
| Current liabilities: | | |
| Accounts payable | $ 1,807 | $ 4,458 |
| Accrued liabilities | 24,145 | 25,136 |
| Accrued compensation and related expenses | 9,820 | 14,251 |
| Income taxes payable | 1,511 | 1,983 |
| Accrued restructuring charges | 4,396 | 4,624 |
| Accrued merger costs | 390 | 543 |
| Deferred revenue | 54,730 | 51,282 |
| Total current liabilities | 96,799 | 102,277 |
| Accrued restructuring charges, less current portion | 9,682 | 10,543 |
| Accrued merger costs, less current portion | 236 | 389 |
| Commitments and contingencies Stockholders equity | 297,450 | 289,599 |
| Total liabilities and stockholders equity | $404,167 | $402,808 |

See notes to condensed consolidated financial statements.

Table of Contents

**INFORMATICA CORPORATION**

**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**
**(In thousands, except per share data)**
**(Unaudited)**

| | Three Months Ended March 31, 2004 | Three Months Ended March 31, 2003 |
|---|---|---|
| Revenues: | | |
| License | $24,918 | $22,866 |
| Service | 29,255 | 25,555 |
| Total revenues | 54,173 | 48,421 |
| Cost of revenues: | | |
| License | 1,101 | 587 |
| Service | 10,071 | 9,237 |
| Amortization of acquired technology | 574 | 260 |
| Total cost of revenues | 11,746 | 10,084 |
| Gross profit | 42,427 | 38,337 |
| Operating expenses: | | |
| Research and development | 12,905 | 11,340 |
| Sales and marketing | 22,302 | 21,140 |
| General and administrative | 4,978 | 5,396 |
| Amortization of intangible assets | 55 | 25 |
| Amortization of stock-based compensation | 638 | 24 |
| Total operating expenses | 40,878 | 37,925 |
| Income from operations | 1,549 | 412 |
| Interest income and other, net | 689 | 1,123 |
| Income before income taxes | 2,238 | 1,535 |
| Income tax provision | 347 | 493 |
| Net income | $ 1,891 | $ 1,042 |
| Net income per share: | | |
| Basic and diluted | $ 0.02 | $ 0.01 |
| Weighted shares used in calculation of net income per share: | | |
| Basic | 84,811 | 80,530 |
| Diluted | 89,752 | 83,159 |

See notes to condensed consolidated financial statements.

Table of Contents

**INFORMATICA CORPORATION**

**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**
**(In thousands)**
**(Unaudited)**

| | Three Months Ended March 31, 2004 | Three Months Ended March 31, 2003 |
|---|---|---|
| **Operating activities** | | |
| Net income | $ 1,891 | $ 1,169 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 2,731 | 2,927 |
| Provision for doubtful accounts and accounts receivable reserve | (207) | 96 |
| Stock-based compensation | 1,008 | 24 |
| Amortization of intangible assets and acquired technology | 629 | 285 |
| Other | 2 | (18) |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | 8,349 | 7,064 |
| Prepaid expenses and other current assets | (3,534) | 1,077 |
| Other assets | (477) | 14 |
| Accounts payable | (2,651) | (707) |
| Accrued liabilities | (991) | (612) |
| Accrued compensation and related expenses | (4,431) | (1,243) |
| Income taxes payable | (472) | (143) |
| Accrued restructuring charges | (1,089) | (1,193) |
| Accrued merger charges | (93) | |
| Deferred revenue | 3,418 | (415) |
| Net cash provided by operating activities | 4,083 | 8,325 |
| **Investing activities** | | |
| Purchase of property and equipment, net | (846) | (812) |
| Purchases of investments | (51,390) | (64,583) |
| Sales and maturities of investments | 41,667 | 42,590 |
| Net cash used in investing activities | (10,569) | (22,805) |
| **Financing activities** | | |
| Proceeds from issuances of common stock | 5,131 | 2,697 |
| Repurchases and retirements of common stock | | (7,565) |
| Net cash provided by (used in) financing Activities | 5,131 | (4,868) |
| Effect of foreign currency translation on cash and cash equivalents | (195) | (42) |
| Decrease in cash and cash equivalents | (1,550) | (19,390) |
| Cash and cash equivalents at beginning of period | 82,903 | 105,590 |
| Cash and cash equivalents at end of period | $ 81,353 | $ 86,200 |

| | | |
|---|---|---|
| **Supplemental disclosures:** | | |
| Income taxes paid | $ 836 | $ 609 |
| **Supplemental disclosures of noncash investing and financing activities:** | | |
| Unrealized gain (loss) on available-for-sale securities | $ 45 | $ (49) |

See notes to condensed consolidated financial statements.

Table of Contents

**INFORMATICA CORPORATION**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**
**(Unaudited)**

**1. Basis of Presentation**

The accompanying condensed consolidated financial statements of Informatica Corporation ( the Company ) have been prepared in conformity with accounting principles generally accepted in the United States. However, certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed, or omitted, pursuant to the rules and regulations of the Securities and Exchange Commission ( SEC ). In the opinion of management, the financial statements include all adjustments necessary (which are of a normal and recurring nature) for the fair presentation of the results of the interim periods presented. All of the amounts included in this report related to the condensed consolidated financial statements and notes thereto as of and for the three months ended March 31, 2004 and 2003 are unaudited. The interim results presented are not necessarily indicative of results for any subsequent interim period, the year ended December 31, 2004 or any future period.

Certain amounts in the Company s March 31, 2003 consolidated financial statements were reclassified to conform with the current period presentation.

Approximately $19.8 million in municipal securities have been reclassified from cash and cash equivalents to short-term investments at March 31, 2003.

For the three months ended March 31, 2003, license revenues were decreased by $0.7 million and service revenues were increased by $0.6 million due to an error in the allocation of revenues between license and service components in accordance with Statement of Position 98-9, *Modification of SOP 97-2, Software Revenue Recognition, with Respect to Certain Transactions* ( SOP 98-9 ). The error was corrected in the fourth quarter of 2003. The Company did not amend any of its periodic reports previously filed with the SEC, however, the previously reported 2003 quarterly results have been adjusted in this Form 10-Q to reflect the impact of the error.

Amortization of acquired technology has been reclassified to cost of revenues for the three months ended March 31, 2003 from amortization of goodwill and other intangible assets.

These unaudited condensed consolidated financial statements should be read in conjunction with our audited consolidated financial statements and notes thereto for the year ended December 31, 2003 included in the Company s Annual Report on Form 10-K filed with the SEC. The condensed consolidated balance sheet as of December 31, 2003 has been derived from the audited consolidated financial statements of the Company.

**2. Revenue Recognition**

The Company generates revenues from sales of software licenses and services, which consist of maintenance, consulting and training. The Company s license revenues are derived from its data integration and business intelligence software and are also derived from analytic application suites and data warehouse modules, which the Company ceased selling directly in July 2003. The Company receives software license revenues from licensing its products directly to end users and indirectly through resellers, distributors and OEMs. The Company receives service revenues from maintenance contracts, consulting services and training that it performs for customers that license its products either directly from the Company or indirectly through resellers, distributors and OEMs.

The Company recognizes revenue in accordance with SOP 97-2 ( SOP 97-2 ) *Software Revenue Recognition,* as amended and modified by SOP 98-9, *Modification of SOP 97-2, Software Revenue Recognition, With Respect to Certain Transactions.* The Company recognizes license revenues when a noncancelable license agreement has been signed, the product has been shipped or the Company has provided the customer with the access codes that allow for immediate possession of the software, the fees are fixed or

Table of Contents

**INFORMATICA CORPORATION**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

determinable, collectibility is probable and vendor-specific objective evidence of fair value ( VSOE ) exists to allocate the fee to the undelivered elements of the arrangement. VSOE is based on the price charged when an element is sold separately. In the case of an element not yet sold separately, the price, which does not change before the element is made generally available, is established by authorized management. If an acceptance period is required, the Company recognizes revenue upon customer acceptance or the expiration of the acceptance period if all other revenue recognition criteria under SOP 97-2 have been satisfied. Credit-worthiness and collectibility for end users are first assessed on a country level and then, for those customers in countries deemed to have sufficient timely payment history, customers are assessed based on payment history and credit profile. When a customer is not deemed credit-worthy, revenue is recognized upon cash receipt, after all other revenue recognition criteria have been satisfied. For the data integration products, data warehouse modules and business intelligence platform sold directly to end users, the Company recognizes revenue upon shipment when collectibility is probable and after all other revenue recognition criteria have been satisfied. The Company ceased selling date warehouse modules in July 2003. For the Company s analytic application suites, which the Company ceased selling directly in July 2003, it recognizes both the license and maintenance revenue ratably over the initial maintenance period, generally one year, since the Company does not have VSOE of maintenance for its analytic application suites.

The Company also enters into reseller and distributor arrangements that typically provide for sublicense or end user license fees based on a percentage of list prices. Revenue arrangements with resellers and distributors require evidence of sell-through, that is, persuasive evidence that the products have been sold to an identified end user. For data integration products, data warehouse modules and business intelligence platform sold indirectly through the Company s resellers and distributors, the Company recognizes revenue upon shipment and receipt of evidence of sell-through if the reseller or distributor has been deemed credit-worthy. Credit-worthiness and collectibility for resellers and distributors are first assessed on a country level and then, for those resellers and distributors in countries deemed to have sufficient timely payment history, resellers and distributors are assessed based on established credit history consisting of sales of at least one million dollars and with timely payment history, generally for the last 12 months. When resellers and distributors are not deemed credit-worthy, revenue is recognized upon cash receipt; for both cases, revenue is recognized after all other revenue recognition criteria have been satisfied. The Company s standard agreements do not contain product return rights.

The Company also enters into OEM arrangements that provide for license fees based on inclusion of the Company s products in the OEMs products. These arrangements provide for fixed, irrevocable royalty payments. Credit-worthiness and collectibility for OEMs are first assessed on a country level and then, for those OEMs in countries deemed to have sufficient timely payment history, OEMs are assessed based on established credit history consisting of sales of at least $1,000,000 and with timely payment history, generally for the last 12 months. For credit-worthy OEMs, royalty payments are recognized based on the activity in the royalty report the Company receives from the OEM, or in the case of OEM s with fixed royalty payments, revenue is recognized when the related payment is due. When OEMs are not deemed credit-worthy, revenue is recognized upon cash receipt, after all other revenue recognition criteria have been satisfied.

The Company recognizes maintenance revenues, which consist of fees for ongoing support and product updates, ratably over the term of the contract, typically one year. Consulting revenues are primarily related to implementation services and product enhancements performed on a time-and-materials basis or, on a very infrequent basis, a fixed fee arrangement under separate service arrangements related to the installation and implementation of our software products. Training revenues are generated from classes offered at the Company s headquarters, sales offices and customer locations. Revenues from consulting and training services are recognized as the services are performed. When a contract includes both license and service elements, the license fee is recognized on delivery of the software or cash collections, provided services do not include significant customization or modification of the base product, and are not otherwise essential to the

Table of Contents

**INFORMATICA CORPORATION**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

functionality of the software and the payment terms for licenses are not dependent on additional acceptance criteria.

Deferred revenue includes deferred license, maintenance, consulting and training revenue. The Company s practice is to net unpaid deferred items against the related receivables balances from those OEMs, specific resellers, distributors and specific international customers for which we defer revenue until payment is received.

### 3. Intangible Assets and Goodwill

Intangible assets, excluding goodwill, consist of the following (in thousands)

| | March 31, 2004 | | | December 31, 2003 | | |
|---|---|---|---|---|---|---|
| | Gross Carrying Amount | Accumulated Amortization | Net Intangible Assets | Gross Carrying Amount | Accumulated Amortization | Net Intangible Assets |
| Core technology | $6,395 | $(3,570) | $2,825 | $6,355 | $(3,343) | $3,012 |
| Developed technology | 1,775 | (714) | 1,061 | 1,775 | (359) | 1,416 |
| Customer relationships | 945 | (95) | 850 | 945 | (48) | 897 |
| Patents | 297 | (297) | | 297 | (297) | |
| Total intangible assets | $9,412 | $(4,676) | $4,736 | $9,372 | $(4,047) | $5,325 |

Amortization expense of intangible assets was approximately $0.6 million and $0.3 million for the three months ended March 31, 2004 and 2003, respectively. The weighted-average amortization period of the Company s core technology, developed technology, customer relationships and patents are three and one half years, one and one quarter years, five years and three years, respectively. The amortization expense related to identifiable intangible assets as of March 31, 2004 is expected to be $1.9 million for the remainder of 2004 and $1.1 million, $1.1 million, $0.5 million and $0.1 million for the years ended December 31, 2005, 2006, 2007 and 2008, respectively.

In 2003 and in the quarter ended March 31, 2004, the Company recorded an increase in goodwill of $51.9 million and a decrease of $0.2 million, respectively, related to the Striva acquisition see Note 8, Business Combinations.

### 4. Net Income Per Share

Under the provisions of SFAS No. 128, *Earnings per Share,* basic net income per share is computed using the weighted-average number of common shares outstanding during the period. Diluted net income per share reflects the potential dilution of securities by adding other common stock equivalents, primarily stock options, to the weighted-average number of common shares outstanding during the period, if dilutive, using the treasury stock method. Potentially dilutive securities have been excluded from the computation of diluted net income per share if their inclusion is antidilutive.

Table of Contents

**INFORMATICA CORPORATION**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The calculation of basic and diluted net income per share is as follows (in thousands, except per share data):

| | Three Months Ended March 31, | |
|---|---|---|
| | 2004 | 2003 |
| Net income | $ 1,891 | $ 1,042 |
| Weighted-average shares outstanding | 85,146 | 80,530 |
| Weighted-average unvested common shares subject to repurchase | (335) | |
| Weighted-average basic common shares | 84,811 | 80,530 |
| Effect of dilutive securities (stock options) | 4,941 | 2,629 |
| Weighted-average diluted common stares | 89,752 | 83,159 |
| Net income per share: | | |
| Basic and diluted | $ 0.02 | $ 0.01 |

**5. Stock-Based Compensation**

The Company accounts for stock issued to employees using the intrinsic value method in accordance with Accounting Principles Board Opinion No. 25 ( APB 25 ), *Accounting for Stock Issued to Employees,* and complies with the disclosure provisions of SFAS No. 123 ( SFAS 123 ), *Accounting for Stock-Based Compensation* and SFAS No. 148 ( SFAS 148 ), *Accounting for Stock-Based Compensation Transition and Disclosure.* Under APB 25, compensation expense of fixed stock options is based on the difference, if any, on the date of the grant between the fair value of the Company s stock and the exercise price of the option. The Company accounts for stock issued to non-employees in accordance with the provisions of SFAS 123 and EITF No. 96-18, *Accounting for Equity Instruments That are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services.*

Pro forma information regarding net income and net income per share is required by SFAS 148 as if the Company had accounted for its employee stock options and shares issued under the Employee Stock Purchase Plan under the fair value method of SFAS 123. The fair value of the Company s stock-based awards to employees was estimated using a Black-Scholes option-pricing model.

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. The Black-Scholes model requires the input of highly subjective assumptions. Because the Company s stock-based awards have characteristics significantly different from those in traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in management s opinion, the existing models do not necessarily provide a reliable single measure of the fair value of its stock-based awards.

Had compensation cost for the Company s stock-based compensation plans been determined using the fair value at the grant dates for awards under those plans calculated using the Black-Scholes method of

Table of Contents

**INFORMATICA CORPORATION**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

SFAS 123, the Company s net income and basic and diluted net income per share would have been changed to the pro forma amounts indicated below (in thousands, except per share data):

| | Three Months Ended March 31, | |
|---|---|---|
| | 2004 | 2003 |
| Net income, as reported | $ 1,891 | $ 1,042 |
| Add: stock-based compensation expense included in reported net income, net of related tax effects | 638 | 24 |
| Deduct: total stock-based compensation expense determined under fair value method for all awards, net of related tax effects | (3,411) | (6,621) |
| Net loss, pro forma | $ (882) | $ (5,555) |
| Basic and diluted net income per share, as reported | $ 0.02 | $ 0.01 |
| Basic and diluted net loss per share, pro forma | $ (0.01) | $ (0.7) |

These pro forma amounts may not be representative of the effects on reported net income (loss) for future years as options vest over several years and additional awards are generally made each year.

In addition to the $0.6 million of stock-based compensation expense included in reported net income above, the Company recorded $0.4 million related to the acceleration of stock options for terminated employees in the three months ended March 31, 2004.

## 6. Comprehensive Income (Loss)

The components of comprehensive income (loss) are as follows (in thousands):

| | Three Months Ended March 31, | |
|---|---|---|
| | 2004 | 2003 |
| Net income | $ 1,891 | $ 1,042 |
| Other comprehensive income: | | |
| Unrealized gain (loss) on investments | 45 | (49) |
| Foreign currency translation adjustment | (224) | (42) |
| Comprehensive income | $ 1,712 | $ 951 |

**7. Recent Accounting Pronouncements**

In January 2003, the FASB issued Interpretation No. 46 ( FIN 46 ), *Consolidation of Variable Interest Entities* , which was amended by FIN 46R issued in December 2003. This interpretation of Accounting Research Bulletin (ARB) No. 51, *Consolidated Financial Statements* establishes accounting guidance for consolidation of a variable interest entity ( VIE ), formerly referred to as special purpose entities. FIN 46 applies to any business enterprise, both public and private, that has a controlling interest, contractual relationship or other business relationship with a VIE. FIN 46 provides guidance for determining when an entity, the Primary Beneficiary, should consolidate another entity, a VIE, that functions to support the activities of the Primary Beneficiary. This Interpretation applies immediately to VIEs created after January 31, 2003. It also applies in the first fiscal year or interim period ending after March 15, 2004, to VIEs created before February 1, 2003 in which an enterprise holds a variable interest. FIN 46 requires disclosure of VIEs in financial statements issued after January 31, 2003, if it is reasonably possible that as of the transition date: (1) the company will be the primary beneficiary of an existing VIE that will require consolidation or, (2) the company will hold a significant

INFORMATICA CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

variable interest in, or have significant involvement with, an existing VIE. The Company currently has no contractual relationship or other business relationship with a VIE, therefore the adoption did not have any effect on the Company s consolidated financial position or results of operations.

**8. Business Combination**

On September 29, 2003, the Company acquired Striva Corporation ( Striva ), a privately held mainframe data integration software vendor. The acquisition extends Informatica s data integration and business intelligence software to include Striva s mainframe technology for high-speed bulk data movement and solution for real-time change data capture in legacy and non-legacy environments.

Management believes that it is the investment value of this synergy related to future product offerings that principally contributed to a purchase price that resulted in the recognition of goodwill. The Company paid $58.5 million, consisting of $30.7 million of cash and 3,189,839 shares of the Company s common stock valued at $27.8 million, to acquire all of the outstanding common and preferred shares of Striva, including the assumption by the Company of all of the outstanding stock options issued pursuant to Striva s stock option plan, which became options to purchase 345,220 shares of the Company s common stock. The acquisition was accounted for using the purchase method of accounting.

The Company decreased the amount allocated to goodwill by $0.2 million from the $51.9 million amount previously reported at December 31, 2003 to $51.7 million for the quarter ended March 31, 2004. The decrease in the goodwill was primarily a result of an adjustment to the merger accrual related to a facilities lease. The Company anticipates that none of the $62.1 million of the goodwill and intangible assets recorded in connection with the Striva acquisition will be deductible for income tax purposes.

The accrued merger costs include transaction costs and an accrual for excess leased facilities formerly occupied by Striva. In accordance with EITF No. 95-3, *Recognition of Liabilities in Connection with a Business Combination* ( EITF 95-3 ), the liability associated with this restructuring is considered a liability assumed in the purchase price allocation. As noted above, the merger accrual was adjusted in the first quarter of 2004. The Company decreased the merger accrual by $0.2 million from the $1.9 million amount previously reported at December 31, 2003 to $1.7 million. Of the $1.7 million accrued merger costs included in the purchase price, $0.1 million was paid during the quarter ended March 31, 2004 and $1.0 million was paid during the year ended December 31, 2003. As of March 31, 2004, $0.4 million was classified as current liabilities and $0.2 million was classified as noncurrent liabilities.

The total fair value of the options assumed was $2.3 million, of which $1.0 million was included in the purchase price. The remaining $1.3 million was classified as deferred compensation and is being amortized over the remaining vesting period of the underlying awards. As a result of the acquisition, three employees of Striva granted the Company a right to repurchase, subject to continued employment, a certain number of shares of the Company s common stock at a price of $0.001 per share. As a result, an additional $3.4 million (representing the closing stock price on the effective date of the acquisition multiplied by the number of shares) was recorded as deferred stock-based compensation and is being amortized as the right to repurchase lapses. The Company recorded amortization expense of $0.7 million in the quarter ended March 31, 2004 related to the deferred compensation. The Company expects to record amortization expense of approximately $1.4 million for the remainder of 2004 and $1.4 million, $0.2 million and $11,000 in 2005, 2006 and 2007, respectively.

The results of Striva s operations have been included in the condensed consolidated financial statements since the acquisition date. Pro forma results of operations have not been presented since the effects of the acquisition were not material to the Company s actual results of operations for the periods presented.

**Table of Contents**

**INFORMATICA CORPORATION**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

## 9. Restructuring Charges

During the third quarter of 2001, the Company announced a restructuring plan and recorded restructuring charges of approximately $12.1 million, consisting of $1.5 million in leasehold improvement and asset write-offs and $10.6 million related to the consolidation of excess leased facilities in the San Francisco Bay Area and Texas.

During the third quarter of 2002, the Company recorded additional restructuring charges of approximately $17.0 million, consisting of $15.1 million related to estimated facility lease losses and $1.9 million in leasehold improvement and asset write-offs. The timing of the restructuring accrual adjustment was a result of negotiated and executed subleases for the Company s excess facilities in Dallas, Texas and Palo Alto, California during the third quarter of 2002. These subleases included terms that provided a lower level of sublease rates than the initial assumptions. The terms of these new subleases were consistent with the continued deterioration of the commercial real estate market in these areas. In addition, cost containment measures initiated in the same quarter, such as delayed hiring and salary reductions, resulted in an adjustment to management s estimate of occupancy of available vacant facilities. These charges represented adjustments to the original assumptions, including the time period that the buildings will be vacant, expected sublease rates, expected sublease terms and the estimated time to sublease. The Company calculated the estimated costs for the additional restructuring charges based on current market information and trend analysis of the real estate market in the respective area.

Actual future cash requirements may differ from the restructuring liability balances as of March 31, 2004 if the Company continues to be unable to sublease the excess leased facilities, there are changes to the time period that facilities are vacant, or the actual sublease income is different from current estimates.

Inherent in the estimation of the costs related to the restructuring efforts are assessments related to the most likely expected outcome of the significant actions to accomplish the restructuring. The estimates of sublease income may vary significantly depending, in part, on factors which may be beyond the Company s control, such as the time periods required to locate and contract suitable subleases and the market rates at the time of such subleases. If the Company is unable to sublease any of the available vacant facilities during the remaining lease terms from the first quarter of 2005 through 2007, restructuring charges could increase by approximately $3.2 million. If the Company does not occupy certain available vacant facilities during the remaining lease terms from 2008 through 2013, restructuring charges could increase by approximately an additional $15.5 million.

A summary of the activity of the accrued restructuring charges for the three months ended March 31, 2004 is as follows (in thousands):

| | Accrued Restructuring Charges at December 31, 2003 | Adjustments | Net Cash Payments | Non-Cash Charges | Accrued Restructuring Charges at March 31, 2004 |
|---|---|---|---|---|---|
| Excess leased facilities | $ 15,167 | $ | $ (1,089) | $ | $ 14,078 |

As of March 31, 2004, $4.4 million of the $14.1 million accrued restructuring charges was classified as current liabilities and the remaining $9.7 million was classified as noncurrent liabilities.

## 10. Warranties and Indemnification

***Warranties***

The Company generally provides a warranty for its software products and services to its customers for a period of three to nine months and accounts for its warranties under SFAS No. 5, *Accounting for*

Table of Contents

**INFORMATICA CORPORATION**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

*Contingencies.* The Company s software products media are generally warranted to be free of defects in materials and workmanship under normal use and the products are also generally warranted to substantially perform as described in certain Company documentation. The Company s services are generally warranted to be performed in a professional manner and to materially conform to the specifications set forth in a customer s signed contract. In the event there is a failure of such warranties, the Company generally will correct or provide a reasonable work around or replacement product. The Company has provided a warranty accrual of $0.2 million as of March 31, 2004 and December 31, 2003. To date, the Company s product warranty expense has not been significant.

***Indemnifications***

The Company sells software licenses and services to its customers under contracts, which the Company refers to as the License to Use Informatica Software ( License Agreement ). Each License Agreement contains the relevant terms of the contractual arrangement with the customer, and generally includes certain provisions for indemnifying the customer against losses, expenses, and liabilities from damages that may be awarded against the customer in the event the Company s software is found to infringe upon a patent, copyright, trademark, or other proprietary right of a third party. The License Agreement generally limits the scope of and remedies for such indemnification obligations in a variety of industry-standard respects, including but not limited to certain time and scope limitations and a right to replace an infringing product.

The Company believes its internal development processes and other policies and practices limit its exposure related to the indemnification provisions of the License Agreement. In addition, the Company requires its employees to sign a proprietary information and inventions agreement, which assigns the rights to its employees development work to the Company. To date, the Company has not had to reimburse any of its customers for any losses related to these indemnification provisions and no material claims against the Company are outstanding as of March 31, 2004. For several reasons, including the lack of prior indemnification claims and the lack of a monetary liability limit for certain infringement cases under the Software Agreement, the Company cannot determine the maximum amount of potential future payments, if any, related to such indemnification provisions.

**11. Litigation**

On November 8, 2001, a purported securities class action complaint was filed in the United States District Court for the Southern District of New York. The case is entitled In re Informatica Corporation Initial Public Offering Securities Litigation, Civ. No. 01-9922 (SAS) (S.D.N.Y.), related to In re Initial Public Offering Securities Litigation, 21 MC 92 (SAS) (S.D.N.Y.). Plaintiffs amended complaint was brought purportedly on behalf of all persons who purchased the Company s common stock from April 29, 1999 through December 6, 2000. It names as defendants Informatica Corporation, one of the Company s current officers, and one of the Company s former officers (the Informatica defendants ), and several investment banking firms that served as underwriters of the Company s April 29, 1999 initial public offering and September 28, 2000 follow-on public offering. The complaint alleges liability as to all defendants under Sections 11 and/or 15 of the Securities Act of 1933 and Sections 10(b) and/or 20(a) of the Securities Exchange Act of 1934, on the grounds that the registration statements for the offerings did not disclose that: (1) the underwriters had agreed to allow certain customers to purchase shares in the offerings in exchange for excess commissions paid to the underwriters; and (2) the underwriters had arranged for certain customers to purchase additional shares in the aftermarket at predetermined prices. The complaint also alleges that false analyst reports were issued. No specific damages are claimed.

Similar allegations were made in other lawsuits challenging over 300 other initial public offerings and follow-on offerings conducted in 1999 and 2000. The cases were consolidated for pretrial purposes. On February 19, 2003, the Court ruled on all defendants motions to dismiss. The Court denied the motions to

Table of Contents

**INFORMATICA CORPORATION**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

dismiss the claims under the Securities Act of 1933. The Court denied the motion to dismiss the Section 10(b) claim against Informatica and 184 other issuer defendants. The Court denied the motion to dismiss the Section 10(b) and 20(a) claims against the Informatica defendants and 62 other individual defendants.

The Company has decided to accept a settlement proposal presented to all issuer defendants. In this settlement, plaintiffs will dismiss and release all claims against the Informatica defendants, in exchange for a contingent payment by the insurance companies collectively responsible for insuring the issuers in all of the IPO cases, and for the assignment or surrender of control of certain claims the Company may have against the underwriters. The Informatica defendants will not be required to make any cash payments in the settlement, unless the pro rata amount paid by the insurers in the settlement exceeds the amount of the insurance coverage, a circumstance which the Company does not believe will occur. The settlement will require approval of the Court, which cannot be assured, after class members are given the opportunity to object to the settlement or opt out of the settlement.

On July 15, 2002, the Company filed a patent infringement action in U.S. District Court in Northern California against Acta Technology, Inc. ( Acta ), now known as Business Objects Data Integration, Inc. ( BODI ), asserting that certain Acta products infringe on three of our patents: U.S. Patent No. 6,014,670, entitled Apparatus and Method for Performing Data Transformations in Data Warehousing ; U.S. Patent No. 6,339,775, entitled Apparatus and Method for Performing Data Transformations in Data Warehousing (this patent is a continuation-in-part of and claims the benefit of U.S. Patent No. 6,014,670); and U.S. Patent No. 6,208,990, entitled Method and Architecture for Automated Optimization of ETL Throughput in Data Warehousing Applications. On July 17, 2002, the Company filed an amended complaint alleging that Acta products also infringe on one additional patent: U.S. Patent No. 6,044,374, entitled Object References for Sharing Metadata in Data Marts. In the suit, the Company is seeking an injunction against future sales of the infringing Acta/ BODI products, as well as damages for past sales of the infringing products. The Company has asserted that BODI s infringement of the Informatica patents was willful and deliberate. On September 5, 2002, BODI answered the complaint and filed counterclaims against us seeking a declaration that each patent asserted is not infringed and is invalid and unenforceable. BODI did not make any claims for monetary relief against us. The parties presented their respective claim constructions to the Court on September 24, 2003 and are awaiting the Court s ruling. The matter is currently in the discovery phase.

The Company is also a party to various legal proceedings and claims, either asserted or unasserted, arising from the normal course of business activities.

In management s opinion, resolution of any of these matters is not expected to have a material adverse impact on the results of operations, cash flows or financial position of the Company. However, depending on the amount and timing, an unfavorable resolution of these matters could materially and adversely affect the Company s future results of operations, cash flows or financial position in a future period.

**Table of Contents**

**Item 2.** ***Management s Discussion and Analysis of Financial Condition and Results of Operations***

This Quarterly Report on Form 10-Q includes forward-looking statements within the meaning of the federal securities laws, particularly statements referencing our expectations relating to service revenues, cost of license revenues as a percentage of license revenues, cost of service revenues as a percentage of service revenues and operating expenses as a percentage of total revenues; international expansion beyond North America and Europe; the recording of amortization expense for acquired technology, intangibles and stock-based compensation; the integration of our recent acquisition of Striva Corporation with the rest of our operations; the ability of our products to meet customer demand; our ability to provide continuing support to our current analytic application customers; the extent to which we may generate revenues from the use or sale of elements of our analytic applications; the sufficiency of our cash balances and cash flows for the next 12 months; potential investments of cash or stock to acquire or invest in complementary businesses, products or technologies; the impact of recent changes in accounting standards; and assumptions underlying any of the foregoing. In some cases, forward-looking statements can be identified by the use of terminology such as may, will, expects, intends, plans, anticipates, estimates, potential, or continue, or the negative thereof or other comparable termi Although we believe that the expectations reflected in the forward-looking statements contained herein are reasonable, these expectations or any of the forward-looking statements could prove to be incorrect, and actual results could differ materially from those projected or assumed in the forward-looking statements. Our future financial condition and results of operations, as well as any forward-looking statements, are subject to risks and uncertainties, including but not limited to the factors set forth under the heading Risk Factors . All forward-looking statements and reasons why results may differ included in this report are made as of the date hereof, and we assume no obligation to update any such forward-looking statements or reasons why actual results may differ.

The following discussion should be read in conjunction with our condensed consolidated financial statements and notes thereto appearing elsewhere in this report.

**Overview**

We are a leading provider of data integration and business intelligence software. We generate revenues from sales of software licenses and services, which consist of maintenance, consulting and training. Our license revenues are derived from our data integration and business intelligence software products, as well as our analytic application suites and data warehouse modules, which we ceased selling directly in July 2003. We receive software license revenues from licensing our products directly to end users and indirectly through resellers, distributors and OEMs. We receive service revenues from maintenance contracts, consulting services and training that we perform for customers that license our products either directly or indirectly. For the three months ended March 31, 2004, license revenues received directly from our end users accounted for 61% of total license consolidated revenues, while license revenues received indirectly through our indirect channel partners accounted for 39% of total consolidated license revenues. In addition, we are continuing to focus our resources on providing infrastructure solutions and to strengthening relationships with several of our indirect channel partners due to our exit from the analytic applications business in July 2003.

We license our software and provide services to all industry sectors, including financial services, communications, pharmaceuticals, insurance, manufacturing, utilities, government and retail. We sell our products through both our own direct sales forces and indirect channel partners in the United States as well as Belgium, Canada, France, Germany, the Netherlands, Switzerland, the United Kingdom, Asia-Pacific, Australia, Europe, Japan and Latin America. Substantially all of our international sales have been in Europe. Revenue outside of Europe and North America, which includes the United States and Canada, has been 4% or less of total consolidated revenues during the last two years, although we anticipate further expansion outside of these two regions in the future.

In the quarter ended March 31, 2004, revenues grew by 12% to $54.2 million from $48.4 million in the same period one year ago. In addition, we continue to be profitable on a quarterly basis, generating net income of $1.9 million, or $0.02 per diluted share, for the quarter. Increases in both license and services revenue continue to offset the loss of analytical application suite and data warehouse module revenue.

Table of Contents

**Adjustments to Previously Announced 2003 Quarterly Results**

In the fourth quarter of 2003, we discovered an error in the allocation of revenues between license and service components in accordance with Statement of Position 98-9, *Modification of SOP 97-2, Software Revenue Recognition, with Respect to Certain Transactions* ( SOP 98-9 ). This allocation methodology had been applied consistently from the fourth quarter of 1999. We immediately corrected the error in the fourth quarter of 2003. We did not amend any of our periodic reports previously filed with the SEC or revise any results prior to 2003. However, we have adjusted our previously reported 2003 quarterly results in this report and the Selected Quarterly Consolidated Financial Data (Unaudited), in the notes to consolidated financial statements filed in the Company s 2003 Annual Report on Form 10-K to reflect the impact of the error.

**Critical Accounting Policies**

Our consolidated financial statements are prepared in accordance with generally accepted accounting principles in the United States, or GAAP. These accounting principles require us to make certain estimates, judgments and assumptions. We believe that the estimates, judgments and assumptions upon which we rely are reasonable based upon information available to us at the time that these estimates, judgments and assumptions are made. These estimates, judgments and assumptions can affect the reported amounts of assets and liabilities as of the date of the financial statements, as well as the reported amounts of revenues and expenses during the periods presented. To the extent there are material differences between these estimates, judgments or assumptions and actual results, our financial statements will be affected.

Our senior management has reviewed these critical accounting policies and related disclosures with our Audit Committee. See Note 1 of notes to consolidated financial statements filed in the Company s 2003 Annual Report on Form 10-K, which contains additional information regarding our accounting policies and other disclosures required by GAAP. We believe the following critical accounting policies involve our more significant judgments and estimates used in the preparation of our condensed consolidated financial statements:

***Revenue Recognition***

We follow detailed revenue recognition guidelines, which are discussed below. We recognize revenue in accordance with GAAP guidance that has been prescribed for the software industry. The accounting rules related to revenue recognition are complex and are affected by interpretations of the rules and an understanding of industry practices, both of which are subject to change. Consequently, the revenue recognition accounting rules require management to make significant judgments, such as determining if collectibility is probable and if a customer is credit-worthy. For example, in the three months ended March 31, 2004, management determined that four countries had sufficient credit-worthiness to warrant a re-assessment of our revenue recognition policy, such that revenue generated from these countries is now recognized upon delivery of the product as opposed to receipt of cash, assuming it is a credit-worthy customer. In addition, management determined that the credit-worthiness of one significant customer had deteriorated to the point that management felt it was necessary to defer the recognition of revenue from such customer until such time as we receive payment for our products.

We recognize revenue in accordance with AICPA Statement of Position (SOP) 97-2 *Software Revenue Recognition,* as amended and modified by SOP 98-9, *Modification of SOP 97-2, Software Revenue Recognition, With Respect to Certain Transactions.* We recognize license revenues when a noncancelable license agreement has been signed, the product has been shipped or we have provided the customer with the access codes that allow for immediate possession of the software (collectively delivered ), the fees are fixed or determinable, collectibility is probable and vendor-specific objective evidence of fair value exists to allocate the fee to the undelivered elements of the arrangement. Vendor-specific objective evidence is based on the price charged when an element is sold separately. In the case of an element not yet sold separately, the price, which does not change before the element is made generally available, is established by authorized management. If an acceptance period is required, we recognize revenue upon customer acceptance or the expiration of the acceptance period if all other revenue recognition criteria under SOP 97-2 have been

**Table of Contents**

satisfied. Credit-worthiness and collectibility for end users are first assessed on a country level and then, for those customers in countries deemed to have sufficient timely payment history, customers are assessed based on payment history and credit profile. For the data integration products, data warehouse modules, and business intelligence platform sold directly to end users, we recognize revenue upon delivery when collectibility is probable, after all other criteria for revenue recognition have been satisfied. We ceased selling data warehouse modules in July 2003. When a customer is not deemed credit-worthy, revenue is recognized upon cash receipt, after all other revenue recognition criteria have been satisfied. For our analytic application suites, which we ceased selling directly in July 2003, we recognize both the license and maintenance revenue ratably over the initial maintenance period, generally one year, since we do not have VSOE of maintenance for our analytic application suites. Our standard agreements do not contain product return rights.

We also enter into reseller and distributor arrangements that typically provide for sublicense or end user license fees based on a percentage of list prices. Revenue arrangements with resellers and distributors require evidence of sell-through, that is, persuasive evidence that the products have been sold to an identified end user. For data integration products, data warehouse modules and business intelligence platform sold indirectly through our resellers and distributors, we recognize revenue upon delivery and receipt of evidence of sell-through if the reseller or distributor has been deemed credit-worthy. We ceased selling data warehouse modules in July 2003. Credit-worthiness and collectibility for resellers and distributors are first assessed on a country level and then, for resellers and distributors in countries deemed to have sufficient timely payment history, resellers and distributors are assessed based on established credit history consisting of sales of at least $1,000,000 and with timely payment history, generally for the last 12 months. When resellers and distributors are not deemed credit-worthy, revenue is recognized upon cash receipt, after all other revenue recognition criteria have been satisfied.

We also enter into OEM arrangements that provide for license fees based on inclusion of our products in the OEMs products. These arrangements provide for fixed, irrevocable royalty payments. Credit-worthiness and collectibility for OEMs are first assessed on a country level and then, for those OEMs in countries deemed to have sufficient timely payment history, OEMs are assessed based on established credit history consisting of sales of at least $1,000,000 and with timely payment history, generally for the last 12 months. For credit-worthy OEMs, royalty payments are recognized based on the activity in the royalty report we receive from the OEM, or in the case of OEMs with fixed royalty payments, revenue is recognized when the related payment is due. When OEMs are not deemed credit-worthy, revenue is recognized upon cash receipt. In both cases, revenue is recognized after all other revenue recognition criteria have been satisfied.

We recognize maintenance revenues, which consist of fees for ongoing support and product updates and upgrades, ratably over the term of the contract, typically one year. Consulting revenues are primarily related to implementation services and product enhancements performed on a time-and-materials basis or, on a very infrequent basis, a fixed fee arrangement under separate service arrangements related to the installation and implementation of our software products. Training revenues are generated from classes offered at our headquarters, sales offices and customer locations. Revenues from consulting and training services are recognized as the services are performed. When a contract includes both license and service elements, the license fee is recognized on delivery of the software or cash collections, provided services do not include significant customization or modification of the base product, and are not otherwise essential to the functionality of the software and the payment terms for licenses are not dependent on additional acceptance criteria.

Deferred revenue includes deferred license, maintenance, consulting and training revenue. Our practice is to net unpaid deferred items against the related receivables balances from those OEMs, specific resellers, distributors and specific international customers for which we defer revenue until payment is received.

***Allowance for Sales Returns and Doubtful Accounts***

We maintain allowances for doubtful accounts for estimated losses resulting from the inability of our customers to make required payments. In cases where we are aware of circumstances that may impair a specific customer s ability to meet its financial obligations to us, we record a specific allowance against amounts due to us. For all other customers, we recognize allowances for doubtful accounts based on the length of time the receivables are past due, geographic concentrations, the current business environment and our historical experience. If the financial condition of our customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required. For example, we recorded an additional bad debt expense in 2002 related to customers that filed for bankruptcy.

We maintain allowances for sales returns on specific revenue in the same period as the related revenues are recorded. These estimates require management judgment and are based on historical sales returns and other known factors. If these estimates do not adequately reflect future sales returns, revenue could be overstated.

***Impairment of Goodwill***

We assess goodwill for impairment in accordance with Statement of Financial Accounting Standards No. 142 (SFAS 142), which requires that goodwill be tested for impairment at the reporting unit level ( Reporting Unit ) at least annually and more frequently upon the occurrence of certain events, as defined by SFAS 142. Consistent with our determination that we have only one reporting segment, we have determined that there is only one Reporting Unit, specifically the license, implementation and support of our software products. Goodwill was tested for impairment in the annual impairment test on October 31, 2003 using the two-step process required by SFAS 142. First, we reviewed the carrying amount of the Reporting Unit compared to the fair value of the Reporting Unit based on quoted market prices of our common stock and the discounted cash flows based on analyses prepared by management. An excess carrying value compared to fair value would indicate that goodwill may be impaired. Second, if we determine that goodwill may be impaired, then we compare the implied fair value of the goodwill, as defined by SFAS 142, to its carrying amount to determine the impairment loss, if any.

Based on these estimates, we determined that as of October 31, 2003 there were no indications of impairment of goodwill. Since October 31, 2003, there have been no indications of impairment and the next annual impairment test will occur as of October 31, 2004. Assumptions and estimates about future values and remaining useful lives are complex and often subjective. They can be affected by a variety of factors, including external factors such as industry and economic trends, and internal factors such as changes in our business strategy and our internal forecasts. Although we believe the assumptions and estimates we have made in the past have been reasonable and appropriate, different assumptions and estimates could materially impact our reported financial results. Accordingly, future changes in market capitalization or estimates used in discounted cash flows analyses could result in significantly different fair values of the Reporting Unit, which may result in impairment of goodwill.

***Restructuring Charges***

During 2002 and 2001, we recorded significant charges in connection with our excess facilities. The accrued restructuring charges represent gross lease obligations and estimated commissions and other costs (principally leasehold improvements and asset write-offs), offset by estimated gross sublease income expected to be received over the remaining lease terms.

If we determine that there is further deterioration in the estimated sublease rates or in the expected time to sublease our vacant space, we may incur additional restructuring charges in the future and our cash position could be adversely affected. For example, we recorded a restructuring charge in 2001 related to our excess facilities and took an additional charge in 2002 for the excess facilities based on the continued deterioration in the real estate market and low sublease rates. See Note 9, Restructuring Charges, of notes to condensed consolidated financial statements in Item 1. Future adjustments to the charges could result from a change in the time period that the buildings will be vacant, expected sublease rate, expected sublease terms and the estimated time to sublease. We will periodically assess the need to update the original restructuring charges based on the current real estate market information and trend analysis and executed sublease agreements.

These liabilities include management s estimates pertaining to sublease activities. Inherent in the estimation of the costs related to our restructuring efforts are assessments related to the most likely expected

Table of Contents

outcome of the significant actions to accomplish the restructuring. We will continue to evaluate the commercial real estate market conditions periodically to determine if our estimates of the amount and timing of future sublease income are reasonable based on current and expected commercial real estate market conditions. Our estimates of sublease income may vary significantly depending, in part, on factors which may be beyond our control, such as the time periods required to locate and contract suitable subleases and the market rates at the time of such subleases.

***Deferred Taxes***

We recorded a full valuation allowance to reduce all of our deferred tax assets to the amount that is likely to be realized. We have considered future taxable income and ongoing tax planning strategies in assessing the need for a valuation allowance; however, if it were determined that we would be able to realize all or part of our deferred tax assets in the future, an adjustment to the deferred tax asset would increase the results of operations in the period in which such determination was made. Likewise, if we determined that we would not be able to realize all or part of our net deferred tax asset in the future, an adjustment to the deferred tax asset would be charged to results of operations in the period in which such determination was made.

**Results of Operations**

**Three Months Ended Mach 31, 2004 and 2003**

The following table presents certain financial data for the three months ended March 31, 2004 and 2003 as a percentage of total revenues:

| | Three Months Ended March 31, | |
|---|---|---|
| | **2004** | **2003** |
| **Consolidated Statements of Operations Data:** | | |
| Revenues: | | |
| License | 46% | 47% |
| Service | 54 | 53 |
| Total revenues | 100 | 100 |
| Cost of revenues: | | |
| License | 2 | 1 |
| Service | 19 | 19 |
| Amortization of acquired technology | 1 | 1 |
| Total cost of revenues | 22 | 21 |
| Gross profit | 78 | 79 |
| Operating expenses: | | |
| Research and development | 24 | 23 |
| Sales and marketing | 41 | 44 |
| General and administrative | 9 | 11 |
| Amortization of intangibles | | |
| Amortization of stock-based compensation | 1 | |
| Total operating expenses | 75 | 78 |
| Income from operations | 3 | 1 |
| Interest income and other, net | 1 | 2 |

Table of Contents

| | Three Months Ended March 31, | |
|---|---|---|
| | 2004 | 2003 |
| Income before income taxes | 4 | 3 |
| Income tax provision | 1 | 1 |
| Net income | 3% | 2% |
| Cost of license revenues, as a percentage of license Revenues | 4% | 3% |
| Cost of service revenues, as a percentage of service Revenues | 34% | 36% |

**Revenues**

Our total revenues increased to $54.2 million for the three months ended March 31, 2004 from $48.4 million for the three months ended March 31, 2003, representing an increase of $5.8 million or 12%.

Our license revenues increased to $24.9 million for the three months ended March 31, 2004 from $22.9 million for the three months ended March 31, 2003. The $2.0 million or 9% increase for the three months ended March 31, 2004 compared to the same period in 2003 was primarily due to $4.3 million of incremental sales of our new products introduced and major new releases of existing products released in the 12-month period ended March 31, 2004. The increase also included a benefit of $0.8 million from the change in assessment of two European countries credit status from cash basis revenue recognition to recognition upon delivery, as discussed further in *Critical Accounting Policies, Revenue Recognition* . These increases were offset by a decrease in revenues of approximately $0.9 million from the partial cancellation of an order from one of our resellers. Furthermore, license revenue for the three months ended March 31, 2003 included an additional $1.6 million from license revenue attributable to our analytical applications in 2003, which we no longer sell.

Service revenues increased to $29.3 million for the three months ended March 31, 2004 from $25.6 million for the three months ended March 31, 2003. The $3.7 million or 14% increase was primarily due to an increase of $4.3 million in maintenance revenues in 2004, which was associated with strong renewals of maintenance contracts. The increase in maintenance revenues in 2004 was partially offset by a $0.6 million decrease in consulting and training revenues, which was the result of fewer billable consultants performing implementation and training services in 2004. For the remaining quarters of 2004, we expect maintenance revenue to remain strong based on our growing installed customer base, and we expect revenue from consulting and training services to remain relatively consistent with the first three months of 2004.

Our international revenues were $16.9 million and $15.3 million for the three months ended March 31, 2004 and 2003, respectively. The $1.6 million or 10% increase for the three months ended March 31, 2004 compared to the same period in 2003 was primarily due to the continued foreign exchange benefit of the weak US Dollar compared to the Euro and British Pound, plus the continuing increases in maintenance revenues in Europe, which increased approximately 25% as a result of strong renewals of maintenance contracts. The increases in Europe were offset by a 33% decrease in combined license and service revenue attributable to Asia. International revenues as a percentage of total revenues were 31% and 32% for the three months ended March 31, 2004 and 2003, respectively.

While license revenue for the three months ended March 31, 2004 has increased 9% over the same period a year ago, it decreased by 4% from the prior quarter, reflecting more seasonality in license orders than expected in the first quarter. This seasonal reduction in license orders in the first quarter may affect our ability to meet our forecasted sales for the second quarter of 2004. Therefore, our ability to meet our forecast will be highly dependent on our success in converting our sales pipeline into license revenues from orders received and shipped within the quarter. See *Risk Factors We have experienced and could continue to experience fluctuations in our quarterly operating results, especially the amount of license revenue we recognize each quarter, and such fluctuations have caused and could continue to cause our stock price to decline.* Furthermore, we experienced greater than usual sales force turnover during the fourth quarter of 2003 and the first quarter of 2004, which impacted our license revenues in the first quarter of 2004 and may impact our ability to generate license revenues for the remainder of 2004. Additionally, the general economic uncertainty has caused customer purchases to be reduced in amount, deferred or cancelled, and therefore has reduced the overall license pipeline conversion rates in much of 2003 and the first quarter of 2004 and could continue to reduce the rate of conversion of the sales pipeline into license revenue in 2004 or beyond. See *Risk Factors If we are unable to accurately forecast revenues, we may fail to meet stock analysts and investors expectations of our quarterly operating results, which could cause our stock price to decline.* , *Risk Factors We have experienced a reduced sales pipeline and pipeline conversion rate, which has adversely affected the growth of our company and the price of our common stock* and *Risk Factors An increase in turnover rates of our sales force personnel may negatively impact our ability to generate license revenues.*

In July 2003, we ceased direct sales of our analytic application suites and data warehouse modules, which remain available to our indirect channel partners to sell. We will not receive any future revenue from the distribution of our analytic application suites and data warehouse modules from our independent channel partners. We will make appropriate efforts to provide support to our existing analytic application customers and to encourage our existing and prospective customers to work with our independent channel partners. We may further use or sell elements of this technology in the future, which may generate revenues. For example, in December 2003, we licensed elements of this software technology to one of our strategic partners.

Our quarterly operating results have fluctuated in the past and are likely to do so in the future. In particular, our license revenues are not predictable with any significant degree of certainty. In addition, we have historically recognized a substantial portion of our revenues in the last month of each quarter, and more recently, in the last few weeks of each quarter. See *Risk Factors We have experienced and could continue to experience fluctuations in our quarterly operating results, especially the amount of license revenue we recognize each quarter, and such fluctuations have caused and could continue to cause our stock price to decline.*

**Cost of Revenues**

***Cost of License Revenues***

Our cost of license revenues consists primarily of software royalties, product packaging, documentation, and production costs. Cost of license revenues increased to $1.1 million for the three months ended March 31, 2004 from $0.6 million for the three months ended March 31, 2003, representing approximately 4% and 3% of license revenues for those periods. The $0.5 million or 83% increase for the three months ended March 31, 2004 compared to the same period in 2003 was due to changes in our percentage mix of royalty-bearing products and the inclusion in the 2003 period of a refund from one of our third-party software providers. This refund of $0.2 million resulted from an overpayment. For the remainder of 2004, we expect the cost of license revenues as a percentage of license revenues to be relatively consistent with the first three months of 2004.

***Cost of Service Revenues***

Our cost of service revenues is a combination of costs of maintenance, consulting and training revenues. Our cost of maintenance revenues consists primarily of costs associated with customer support personnel expenses and software maintenance fees to third-party software providers. Cost of consulting revenues consists primarily of personnel costs and expenses incurred in providing consulting services at customers facilities. Cost of training revenues consists primarily of the costs of providing training classes and materials at our headquarters, sales and training offices and customer locations. Cost of service revenues increased to $10.1 million for the three months ended March 31, 2004 from $9.2 million for the three months ended March 31, 2003, representing approximately 34% and 36% of service revenues for those periods. The $0.9 million or 10% increase for the three months ended March 31, 2004 compared to the same period in 2003 was primarily due to increased compensation expense of $0.4 million from headcount growth in our customer support group and $0.3 million from increased third-party software maintenance fees. For the remainder of 2004, we expect our cost of service revenues as a percentage of service revenues to be relatively consistent with the first three months of 2004.

Table of Contents

*Amortization of Acquired Technology*

Amortization of acquired technology is the amortization of technologies acquired through business combinations. See additional discussion at *Amortization of Goodwill and Other Intangible Assets* below. Amortization of acquired technology increased to $0.6 million for the three months ended March 31, 2004 from $0.3 million for the three months ended March 31, 2003. For the remainder of 2004, we expect amortization of acquired technology to be approximately $1.7 million, which reflects the increase from the prior year resulting from our acquisition of Striva in September 2003.

**Operating Expenses**

*Research and Development*

Our research and development expenses consist primarily of salaries and other personnel-related expenses associated with the development of new products, the enhancement and localization of existing products, quality assurance and development of documentation for our products. Research and development expenses increased to $12.9 million for the three months ended March 31, 2004 from $11.3 million for the thee months ended March 31, 2003, representing approximately 24% and 23% of total revenues for those periods. The $1.6 million or 14% increase for the three months ended March 31, 2004 compared to the same period in 2003 was due primarily to an increase in compensation costs resulting from an increase in research and development headcount due to expansion of our development center in Bangalore and the acquisition of Striva in the third quarter of 2003. For the remainder of 2004, we expect research and development expenses as a percentage of total revenues to decline in the remaining months of 2004 assuming growth in revenues.

*Sales and Marketing*

Our sales and marketing expenses consist primarily of personnel costs, including commissions, as well as costs of public relations, seminars, marketing programs, lead generation, travel and trade shows. Sales and marketing expenses increased to $22.3 million for the three months ended March 31, 2004 from $21.1 million for the thee months ended March 31, 2003, representing approximately 41% and 44% of total revenues for those periods. The increase of $1.2 million or 6% for the three months ended March 31, 2004 compared to the same period in 2003 was due primarily to increased travel-related expenses of $0.6 million and increased costs for sales kick-off and incentive events totaling $0.8 million, partially offset by a decrease in marketing and trade show expenses of $0.4 million. For the remainder of 2004, we expect sales and marketing expenses as a percentage of total revenues will remain relatively consistent with the first three months of 2004.

*General and Administrative*

Our general and administrative expenses consist primarily of personnel costs for finance, human resources, legal and general management, as well as professional services expense associated with recruiting, legal and accounting. General and administrative expenses decreased to $5.0 million the three months ended March 31, 2004 from $5.4 million for the three months ended March 31, 2003, representing approximately 9% and 11% of total revenues for those periods. The decrease of $0.4 million or 8% for the three months ended March 31, 2004 compared to the same period in 2003 was primarily due to a decrease in fees for outside legal, financial professional and consulting service providers. For the remainder of 2004, we expect general and administrative expenses as a percentage of total revenues will remain consistent with the first three months of 2004.

*Amortization of Stock-Based Compensation*

Amortization of stock-based compensation increased to $0.6 million for the three months ended March 31, 2004 from $24,000 for the three months ended March 31, 2003. The increase in 2004 was primarily related to the amortization of the deferred compensation recorded in connection with the September 2003 Striva acquisition. We expect to record $1.8 million for the remainder of 2004 for the amortization of stock-based compensation related to the fixed awards issued in conjunction with the Striva acquisition.

**Table of Contents**

In 2003, we granted a stock option to our CEO that is based on our future performance. The variable term of the option is such that it requires us to periodically remeasure the value of the grant based on the fair value of our common stock and record related stock-based compensation. The stock-based compensation related to this grant for the three months ended March 31, 2004 was a benefit of $22,000 resulting from a decrease in the market price of our common stock between December 31, 2003 and March 31, 2004. There was no stock compensation related to this grant for the three months ended March 31, 2003. If the fair market value of our common stock for the remainder of 2004 were to remain consistent with the closing price at March 31, 2004, we would expect to record amortization of stock-based compensation related to this grant of approximately $30,000 for the remainder of 2004.

***Amortization of Intangibles***

Goodwill represents the excess of the aggregate purchase price over the fair value of the tangible and identifiable intangible assets we have acquired. Other intangible assets include core technology, developed technology, customer lists and patents. We recorded goodwill and other intangible assets in connection with the acquisitions of Striva Corporation in 2003, syn-T-sys and Informatica Partners in 2001 and Delphi Solutions AG, Zimba and QRB Developers in 2000 as well as the strategic alliance with PricewaterhouseCoopers in 2000.

Amortization of developed technology and core technology is included in amortization of acquired technology (see above). Amortization of intangible assets includes patents and customer lists and amounted to $55,000 and $25,000 for the three months ended March 31, 2004 and 2003, respectively. We expect amortization expense to be approximately $0.1 million for the remainder of 2004, excluding the amortization of acquired technology, which is recognized as a component of cost of revenues.

It is likely that we will continue to expand our business both through acquisitions and internal development. Any additional acquisitions could result in additional merger and acquisition related expenses and any impairment of goodwill and other intangible assets could result in incremental expense.

***Restructuring Charges***

In September 2001, we announced a restructuring plan and recorded restructuring charges of approximately $12.1 million, consisting of $10.6 million related to estimated facility lease losses and $1.5 million in leasehold improvement and asset write-offs related to the consolidation of excess leased facilities in the San Francisco Bay Area and Texas.

In September 2002, we recorded additional restructuring charges of approximately $17.0 million, consisting of $15.1 million related to estimated facility lease losses and $1.9 million in leasehold improvement and asset write-offs. The timing of the restructuring accrual adjustment was a result of negotiated and executed subleases for our excess facilities in Dallas, Texas and Palo Alto, California during the third quarter of 2002. These subleases included terms that provided a lower level of sublease rates than the initial assumptions. The terms of these new subleases were consistent with the continued deterioration of the commercial real estate market in these areas. In addition, cost containment measures initiated in the same quarter, such as delayed hiring and salary reductions, resulted in an adjustment to our estimate of occupancy of available vacant facilities. These charges represented adjustments to the original assumptions including the time period that the buildings are expected to be vacant, expected sublease rates, expected sublease terms and estimated time to sublease. We calculated the additional restructuring charges based on current market information and trend analysis of the real estate market in the respective area.

Net cash payments for the three months ended March 31, 2004 and 2003 related to the consolidation of excess facilities were $1.1 million and $1.2 million, respectively. Actual future cash requirements may differ from the restructuring liability balances as of March 31, 2004 if there are changes to the time period that facilities are vacant, or the actual sublease income is different from current estimates. As of March 31, 2004, $14.1 million of lease termination costs, net of anticipated sublease income related to facilities expected to be subleased, remains accrued and is expected to be paid by 2007.

Table of Contents

Our results of operations were positively affected by the decrease in rent expense, which approximates the cash payments against the restructuring liability of $1.1 million and $1.2 million, and decreases to non-cash depreciation and amortization expense for the property and equipment written-off, totaling $0.1 million and $0.3 million for the three months ended March 31, 2004 and 2003, respectively. For the remainder of 2004, we expect the effect on the results of operations to remain relatively consistent with the first three months of 2004.

If we are unable to sublease any of the available vacant facilities during the remaining lease terms from the fourth quarter of 2004 through 2007, restructuring charges could increase by approximately $3.2 million. We have actual sublease agreements for our excess facilities totaling $1.7 million from the fourth quarter of 2004 through 2007. If we do not occupy certain available vacant facilities during the remaining lease terms from 2008 through 2013, restructuring charges could increase by approximately an additional $15.5 million.

**Interest Income and Other, Net**

Interest income and other, net represents primarily interest income earned on our cash, cash equivalents, investments and restricted cash. Interest income and other, net was $0.7 million and $1.1 million for the three months ended March 31, 2004 and 2003, respectively. The decrease of $0.4 million or 36% for the three months ended March 31, 2004 compared to the same period in 2003 was primarily due to lower interest income earned on our cash, cash equivalents, investments and restricted cash. We currently do not engage in any foreign currency hedging activities and, therefore, are susceptible to fluctuations in foreign exchange gains or losses in our results of operations in future reporting periods.

**Income Tax Provision**

We recorded an income tax provision of $0.3 million and $0.5 million for the three months ended March 31, 2004 and 2003, respectively, which primarily represents federal alternative minimum taxes, income taxes currently payable on income generated in non-U.S. jurisdictions, and foreign withholding taxes. The expected tax provision derived from applying the federal statutory rate to our income before income taxes for the quarter ended March 31, 2004 differed from the recorded income tax provision primarily due to the realization of a portion of previously unbenefitted tax attributes offset by foreign income and withholding taxes.

**Recent Accounting Pronouncements**

In January 2003, the FASB issued Interpretation No. 46 ( FIN 46 ), *Consolidation of Variable Interest Entities ,* which was amended by FIN 46R issued in December 2003. This interpretation of Accounting Research Bulletin (ARB) No. 51, *Consolidated Financial Statements* establishes accounting guidance for consolidation of a variable interest entity ( VIE ), formerly referred to as special purpose entities. FIN 46 applies to any business enterprise, both public and private, that has a controlling interest, contractual relationship or other business relationship with a VIE. FIN 46 provides guidance for determining when an entity, the Primary Beneficiary, should consolidate another entity, a VIE, that functions to support the activities of the Primary Beneficiary. FIN 46 applies immediately to VIEs created after January 31, 2003. It also applies in the first fiscal year or interim period ending after March 15, 2004, to VIEs created before February 1, 2003 in which an enterprise holds a variable interest. FIN 46 requires disclosure of VIEs in financial statements issued after January 31, 2003, if it is reasonably possible that as of the transition date: (1) the company will be the primary beneficiary of an existing VIE that will require consolidation or, (2) the company will hold a significant variable interest in, or have significant involvement with, an existing VIE. We currently have no contractual relationship or other business relationship with a VIE, Therefore the adoption did not have any effect on our consolidated financial position or results of operations.

**Liquidity and Capital Resources**

We have funded our operations primarily through cash flows from operations and public offerings of our common stock. As of March 31, 2004, we had $232.0 million in available cash and cash equivalents and short-term investments and $12.2 million of restricted cash under the terms of our Pacific Shores property leases.

Table of Contents

*Operating Activities:* For the three months ended March 31, 2004 and 2003, net cash flows from operating activities were $4.1 million and $8.3 million, respectively. Cash provided by operating activities in 2004 was primarily due to net income adjusted for non-cash charges for depreciation and amortization and amortization of stock-based compensation, intangible assets and acquired technology. Significant collections in the period, which resulted in decreased accounts receivable, additionally added to net cash provide by operating activities. These additions were offset by substantial payments of our accounts payable, other short-term accrued liabilities and restructuring charges and increases in prepaid expenses.

*Investing Activities:* For the three months ended March 31, 2004 and 2003, net cash flows used in investing activities were $10.6 million and $22.8 million, respectively. Of the $10.6 million of cash used in investing activities for the three months ended March 31, 2004, $51.4 million was used for the purchase of short-term investments and $0.8 million was used for the purchase of property and equipment, while cash generated from the sale and maturities of investments totaled $41.2 million.

*Financing Activities:* For the three months ended March 31, 2004 and 2003, net cash flows provided by (used in) financing activities were $5.1 million and ($4.9) million, respectively. The $5.1 million provided by financing activities in the first three months of 2004 was from proceeds from issuances of our common stock as a result of exercises of outstanding options and a semi-annual purchase under our Employee Stock Purchase Plan in January 2004.

We believe that our cash balances and the cash flows generated by operations will be sufficient to satisfy our anticipated cash needs for working capital and capital expenditures for at least the next 12 months. However, because our operating results may fluctuate significantly as a result of a decrease in customer demand or the acceptance of our products, we may not in the future be able to generate positive cash flows from operations. If this occurred, we would require additional funds to support our working capital requirements, or for other purposes, and may seek to raise such additional funds through public or private equity financings or from other sources. We may not be able to obtain adequate or favorable financing at that time. Any financing we obtain may dilute your ownership interests.

***Operating Leases and Contractual Obligations***

We lease certain office facilities and equipment under noncancelable operating leases. Our payment obligations under these operating leases are included in the table below under the caption Operating Leases. During 2002 and 2001, we recorded restructuring charges related to the consolidation of excess leased facilities in the San Francisco Bay Area and Texas. Our operating lease obligations in the table below include approximately $11.6 million, net of anticipated sublease income, for operating lease commitments for those facilities that are included in accrued restructuring charges as of March 31, 2004. See Note 9 of notes to the condensed consolidated financial statements in Item 1. During 2002, 2003 and the first three months of 2004, we signed sublease agreements for leased office space in Palo Alto, Redwood City, Scotts Valley and San Francisco, California and Carrollton, Texas. Our expected sublease income from these sublease agreements is included in the table below under the caption Sublease Income.

Our future minimum lease payments as of March 31, 2004 under noncancelable operating leases with original terms in excess of one year and sublease income are summarized as follows (in thousands):

| | Operating Leases | Sublease Income | Net |
|---|---|---|---|
| Remaining 2004 | $ 14,289 | $ 936 | $ 13,353 |
| 2005 | 18,534 | 1,098 | 17,436 |
| 2006 | 18,047 | 584 | 17,463 |
| 2007 | 16,846 | 257 | 16,589 |
| 2008 | 16,147 | 67 | 16,080 |
| Thereafter | 77,896 | | 77,896 |
| Total | $161,759 | $2,942 | $158,817 |

In February 2000, we entered into two lease agreements for new corporate headquarters in Redwood City, California. We occupied the new corporate headquarters in August 2001. The lease expires in July 2013. As part of these agreements, we have purchased certificates of deposit totaling $12.2 million as a security deposit for lease payments until certain financial milestones are met. The letter of credit may be reduced to an amount not less than three months of the base rent at the then current rate if our annual revenues reach $750 million and we have quarterly income from operations of at least $100 million for no less than four consecutive calendar quarters. These certificates of deposit are classified as long-term restricted cash on the condensed consolidated balance sheet.

There were no material changes in our contractual obligations from what we disclosed in our Annual Report on Form 10-K for the year ended December 31, 2003.

***Other Uses of Cash***

A portion of our cash may be used to acquire or invest in complementary businesses or products or to obtain the right to use complementary technologies. From time to time, in the ordinary course of business, we may evaluate potential acquisitions of such businesses, products or technologies.

***Off-Balance Sheet Arrangements***

We do not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes.

Table of Contents

## RISK FACTORS

In addition to the other information contained in this Form 10-Q, we have identified the following risks and uncertainties that may have a material adverse effect on our business, financial condition or results of operation. Investors should carefully consider the risks described below before making an investment decision. The risks described below are not the only ones facing our company. Additional risks not presently known to us or that we currently believe are immaterial may also impair our business operations. Our business could be harmed by any of these risks. The trading price of our common stock could decline due to any of these risks and investors may lose all or part of their investment. In assessing these risks, investors should also refer to the other information contained in our other SEC filings, including our Form 10-K for the year ended December 31, 2003.

***We have experienced and could continue to experience fluctuations in our quarterly operating results, especially the amount of license revenue we recognize each quarter, and such fluctuations have caused and could continue to cause our stock price to decline.***

Our quarterly operating results have fluctuated in the past and are likely to do so in the future. These fluctuations have caused our stock price to experience declines in the past and could cause our stock price to significantly fluctuate or experience declines in the future. One of the reasons why our operating results have fluctuated is that our license revenues are not predictable with any significant degree of certainty and are vulnerable to short-term shifts in customer demand. For example, we have experienced customer order deferrals in anticipation of future new product introductions or product enhancements, as well as the particular budgeting and purchase cycles of our customers. By comparison, our short-term expenses are relatively fixed and based in part on our expectations of future revenues.

Moreover, we do not have a substantial backlog of license orders at the end of a fiscal period. Historically, this has been particularly the case at the end of the first and third fiscal quarters. For example, in the three months ended March 31, 2004, we experienced greater seasonal reduction in license orders than we expected. Therefore, our license revenues generally reflect orders shipped in the same quarter they are received, and as a result, we do not have significant visibility of expected results for future quarters. Furthermore, we have recognized a substantial portion of our license revenues in the last month of each quarter, and more recently, in the last few weeks of each quarter. As a result, we cannot predict the adverse impact caused by cancellations or delays in orders until the end of each quarter.

Due to the difficulty we experience in predicting our quarterly license revenues, we believe that quarter-to-quarter comparisons of our operating results are not a good indication of our future performance. Furthermore, our future operating results could fail to meet the expectations of stock analysts and investors. If this happens, the price of our common stock could fall.

***If we are unable to accurately forecast revenues, we may fail to meet stock analysts and investors expectations of our quarterly operating results, which could cause our stock price to decline.***

We use a pipeline system, a common industry practice, to forecast sales and trends in our business. Our sales personnel monitor the status of all proposals, including the date when they estimate that a customer will make a purchase decision and the potential dollar amount of the sale. We aggregate these estimates periodically in order to generate a sales pipeline. We compare the pipeline at various points in time to look for trends in our business. While this pipeline analysis may provide us with some guidance in business planning and budgeting, these pipeline estimates are necessarily speculative and may not consistently correlate to revenues in a particular quarter or over a longer period of time. Additionally, because we have historically recognized a substantial portion of our license revenues in the last month of each quarter, and more recently, in the last few weeks of each quarter, we may not be able to adjust our cost structure in a timely manner in response to variations in the conversion of the sales pipeline into license revenues. Any change in the conversion of the pipeline into customer sales or in the pipeline itself could cause us to improperly budget for future expenses that are in line with our expected future revenues, which would adversely affect our operating margins and results of operations and could cause the price of our common stock to decline.

***We have experienced reduced sales pipeline and pipeline conversion rates in the past, which have adversely affected the growth of our company and the price of our common stock.***

In 2002, we experienced a reduced conversion rate of our overall license pipeline, primarily as a result of the general economic slowdown which caused the amount of customer purchases to be reduced, deferred or cancelled. In the first half of 2003, we continued to experience a decrease in our sales pipeline as well as our pipeline conversion rate, primarily as a result of the negative impact of the war in Iraq on the capital spending budgets of our customers, as well as the continued general economic slowdown. While the U.S. economy improved in the second half of 2003 and the first quarter of 2004, there is still uncertainty regarding our ability to convert potential sales of our products into revenue. If we are unable to increase the size of our sales pipeline and our pipeline conversion rate, our results of operations could fail to meet the expectations of stock analysts and investors, which could cause the price of our common stock to decline.

***An increase in turnover rates of our sales force personnel may negatively impact our ability to generate license revenues.***

We experienced an increased level of turnover in our direct sale force in the fourth quarter of 2003 and the first quarter of 2004. This increase in turnover rates impacted our ability to generate license revenues in the first quarter of 2004. Although we have hired replacements in our sales force, if we are ineffective in assimilating such new personnel, or if we continue to experience a heightened level of sales force turnover, our ability to generate license revenues may be negatively impacted.

***If we do not compete effectively with companies selling data integration and business intelligence products, our revenues may not grow and could decline.***

The market for our products is highly competitive, quickly evolving and subject to rapidly changing technology. Our competition consists of hand-coded, custom-built data integration solutions developed in-house by various companies in the industry segments that we target as well as other vendors of integration software products, including Ascential Software, Embarcadero Technologies, Group 1 Software, Sagent Technologies and certain privately-held companies. In addition, we compete against business intelligence vendors that currently offer, or may develop, products with functionalities that compete with our products, such as Brio Technology, Business Objects, Cognos, Hyperion Solutions, MicroStrategy and certain privately-held companies. We also compete against certain database and enterprise application vendors, which offer products that typically operate specifically with these competitors   proprietary databases. Such potential competitors include IBM, Microsoft, Oracle, PeopleSoft, SAP and Siebel Systems. Many of these competitors have longer operating histories, substantially greater financial, technical, marketing or other resources, or greater name recognition than we do. Our competitors may be able to respond more quickly than we can to new or emerging technologies and changes in customer requirements. Competition could seriously impede our ability to sell additional products and services on terms favorable to us. Our current and potential competitors may develop and market new technologies that render our existing or future products obsolete, unmarketable or less competitive. We believe we currently compete more on the basis of our products functionality than on the basis of price. If our competitors develop products with similar or superior functionality, we may have difficulty competing on the basis of price.

Our current and potential competitors may make strategic acquisitions or establish cooperative relationships among themselves or with other solution providers, thereby increasing the ability of their products to address the needs of our prospective customers. Our current and potential competitors may establish or strengthen cooperative relationships with our current or future strategic partners, thereby limiting our ability to sell products through these channels. Additionally, if any of our current or potential competitors consolidate their operations, and as a result provide a broader suite of software products or solutions, our ability to market and sell our software products could be impaired. Competitive pressures could reduce our market share or require us to reduce our prices, either of which could harm our business, results of operations and financial condition.

Table of Contents

***We may not successfully integrate Striva s technology, employees or business operations with our own. As a result, we may not achieve the anticipated benefits of our acquisition, which could adversely affect our operating results and cause the price of our common stock to decline.***

In September 2003, we acquired Striva Corporation, a provider of mainframe data integration solutions. The successful integration of Striva s technology, employees and business operations will place an additional burden on our management and infrastructure. This acquisition, and any others we may make in the future, will subject us to a number of risks, including:

- the failure to capture the value of the business we acquired, including the loss of any key personnel, customers and business relationships;
- any inability to generate revenue from the combined products that offsets the associated acquisition and maintenance costs; and
- the assumption of any contracts or agreements from Striva that contain terms or conditions that are unfavorable to us.

There can be no assurance that we will be successful in overcoming these risks or any other problems encountered in connection with our Striva acquisition or any future acquisitions. To the extent that we are unable to successfully manage these risks, our business, operating results or financial condition could be adversely affected, and the price of our common stock could decline.

***We rely on our relationships with our strategic partners. If we do not maintain and strengthen these relationships, our ability to generate revenue and control implementation costs could be adversely affected, which would cause a decline in the price of our common stock.***

We believe that our ability to increase the sales of our products depends in part upon maintaining and strengthening relationships with our strategic partners and any future strategic partners. In addition to our direct sales force, we rely on established relationships with a variety of strategic partners, such as systems integrators, resellers and distributors, for marketing, licensing, implementing and supporting our products in the United States and internationally. We also rely on relationships with strategic technology partners, such as enterprise application providers, database vendors and data quality vendors, for the promotion and implementation of our products.

Our strategic partners offer products from several different companies, including, in some cases, products that compete with our products. We have limited control, if any, as to whether these strategic partners devote adequate resources to promoting, selling and implementing our products as compared to our competitors products.

We may not be able to maintain our strategic partnerships or attract sufficient additional strategic partners who have the ability to market our products effectively, are qualified to provide timely and cost-effective customer support and service or have the technical expertise and personnel resources necessary to implement our products for our customers. In particular, if our strategic partners do not devote sufficient resources to implement our products, we may incur substantial additional costs associated with hiring and training additional qualified technical personnel to timely implement solutions for our customers. Furthermore, our relationships with our strategic partners may not generate enough revenue to offset the significant resources used to develop these relationships. If we are unable to leverage the strength of our strategic partnerships to generate additional revenue, our revenues and the price of our common stock could decline.

***If the current improvement in the U.S. economy does not result in increased sales of our products and services, our operating results would be harmed, and the price of our common stock could decline.***

As our business has grown, we have become increasingly subject to the risks arising from adverse changes in the domestic and global economy. We experienced the adverse effect of the economic slowdown in 2002 and the first six months of 2003, which resulted in a significant reduction in capital spending by our customers, as well as longer sales cycles, and the deferral or delay of purchases of our products. In addition, the terrorist actions of September 11, 2001 and the recent military actions in Afghanistan and Iraq magnified and prolonged the adverse effects of the economic slowdown. Although the U.S. economy improved beginning in the third quarter of 2003, we have not experienced any improvement in our pipeline conversion rate in the past three quarters.

If the current improvement in the U.S. economy does not result in increased sales of our products and services, our results of operations could fail to meet the expectations of stock analysts and investors, which could cause the price of our common stock to decline. Moreover, if the current economic conditions in Europe and Asia do not improve or if there is an escalation in regional or global conflicts, we may fall short of our revenue expectations for 2004. In addition, we could experience delays in the payment obligations of our reseller customers if they experience weakness in the end-user market, which would increase our credit risk exposure and harm our financial condition.

***As a result of our products lengthy sales cycle, our expected revenues are susceptible to fluctuations, which could cause us to fail to meet stock analysts and investors expectations, resulting in a decline in the price of our common stock.***

Due to the expense, broad functionality and company-wide deployment of our products, our customers decision to purchase our products typically requires the approval of their executive decision-makers. In addition, we frequently must educate our potential customers about the full benefits of our products, which also can require significant time. Further, our sales cycle may lengthen as we continue to focus our sales efforts on large corporations. As a result of these factors, the length of time from our initial contact with a customer to the customer s decision to purchase our products typically ranges from three to nine months. We are subject to a number of significant risks as a result of our lengthy sales cycle, including:

- our customers budgetary constraints and internal acceptance review procedures;
- the timing of our customers budget cycles;
- the seasonality of technology purchases, which historically has resulted in stronger sales of our products in the fourth quarter of the year, especially when compared to lighter sales in the first quarter of the year;
- our customers concerns about the introduction of our products or new products from our competitors; or
- potential downturns in general economic or political conditions that could occur during the sales cycle.

If our sales cycle lengthens unexpectedly, it could adversely affect the timing of our revenues or increase costs, which may independently cause fluctuations in our revenue and results of operations. Finally, if we are unsuccessful in closing sales of our products after spending significant funds and management resources, our operating margins and results of operations could be adversely impacted.

***If the market in which we sell our products and services does not grow as we anticipate, we may not be able to increase our revenues at an acceptable rate of growth, and the price of our common stock could decline.***

The market for software products that enable more effective business decision-making by helping companies aggregate and utilize data stored throughout an organization, is relatively new and still emerging. Substantially all of our revenues are attributable to the sale of products and services in this market. Our potential customers may:

- not fully value the benefits of using our products;
- not achieve favorable results using our products;
- experience technical difficulties in implementing our products; or
- use alternative methods to solve the problems addressed by our products.

If this market does not grow as we anticipate, we would not be able to sell as much of our software products and services as we currently expect, which could result in a decline in the price of our common stock.

***We rely on the sale of a limited number of products, and if these products do not achieve broad market acceptance, our revenues would be adversely affected.***

To date, substantially all of our revenues have been derived from our data integration products such as PowerCenter, PowerMart, PowerConnect and related services, and to a lesser extent, our analytic application suites, data warehouse modules, business intelligence products and related services. Since we recently ceased direct sales of our analytic application suites and data warehouse modules, we expect sales of our data integration and business intelligence software and related services to comprise substantially all of our revenues for the foreseeable future. If any of these products do not achieve market acceptance, our revenues and stock price could decrease. In particular, with the completion of our Striva acquisition, we will begin selling and marketing Striva s technology as part of our complete product offering. Market acceptance for Striva s products, as well as our current products, could be affected if, among other things, competition substantially increases in the enterprise analytic software marketplace or transactional applications suppliers integrate their products to such a degree that the utility of the data integration functionality that our products provide is minimized or rendered unnecessary.

***We may not be able to successfully manage the growth of our business if we are unable to improve our internal systems, processes and controls.***

We need to continue to improve our internal systems, processes and controls to effectively manage our operations and growth. We may not be able to successfully implement improvements to these systems, processes and controls in an efficient or timely manner, and we may discover deficiencies in existing systems, processes and controls. We have licensed technology from third parties to help us accomplish this objective. We may experience difficulties in managing improvements to our systems, processes and controls or in connection with third-party software, which could disrupt existing customer relationships, causing us to lose customers, limit us to smaller deployments of our products or increase our technical support costs.

***The loss of our key personnel or the inability to attract and retain additional personnel could adversely affect our ability to grow our company successfully.***

We believe our success depends upon our ability to attract and retain highly skilled personnel and key members of our management team. We currently do not have any key-man life insurance relating to our key personnel, and their employment is at-will and not subject to employment contracts. We may not be successful in attracting, assimilating and retaining key personnel in the future, which could adversely affect our ability to grow our company successfully.

***The price of our common stock fluctuates as a result of factors other than our operating results, such as the actions of our competitors and securities analysts, as well as developments in our industry and changes in accounting rules.***

The market price for our common stock has experienced significant fluctuations and may continue to fluctuate significantly. The market price for our common stock may be affected by a number of factors other than our operating results, including:

- the announcement of new products or product enhancements by our competitors;
- quarterly variations in our competitors results of operations;
- changes in earnings estimates and recommendations by securities analysts;
- developments in our industry; and
- changes in accounting rules, such as the recording of expenses related to employee stock option grants.

Table of Contents

After periods of volatility in the market price of a particular company s securities, securities class action litigation has often been brought against that company. We and certain of our officers and directors have been named as defendants in a purported class action complaint, which was filed on behalf of certain persons who purchased our common stock between April 29, 1999 and December 6, 2000. Such actions could cause the price of our common stock to decline.

***If our products are unable to interoperate with hardware and software technologies that are developed and maintained by third parties that are not within our control, our ability to develop and sell our products to our customers could be adversely affected which would result in harm to our business and operating results.***

Our products are designed to interoperate with and provide access to a wide range of third-party developed and maintained hardware and software technologies, which are used by our customers. The future design and development plans of the third parties that maintain these technologies are not within our control and may not be in line with our future product development plans. We may also rely on such third parties to provide us with access to these technologies so that we can properly test and develop our products to interoperate with the third-party technologies. These third parties may in the future refuse or otherwise be unable to provide us with the necessary access to their technologies. In addition, these third parties may decide to design or develop their technologies in a manner that would not be interoperable with our own. If either of these risks occur, we would not be able to continue to market our products as interoperable with such third party hardware and software, which could adversely affect our ability to successfully sell our products to our customers.

***We rely on a number of different distribution channels to sell and market our products. Any conflicts that we may experience within these various distribution channels could result in confusion for our customers and a decrease in revenue and operating margins.***

We have a number of relationships with resellers, systems integrators and distributors which assist us in obtaining broad market coverage for our products and services. Although our discount policies, sales commission structure and reseller licensing programs are intended to support each distribution channel with a minimum level of channel conflicts, we may not be able to minimize these channel conflicts in the future. Any channel conflicts that we may experience could result in confusion for our customers and a decrease in revenue and operating margins.

***Any significant defect in our products could cause us to lose revenue and expose us to product liability claims.***

The software products we offer are inherently complex and despite extensive testing and quality control, have in the past and may in the future contain errors or defects, especially when first introduced. These defects and errors could cause damage to our reputation, loss of revenue, product returns, order cancellations or lack of market acceptance of our products. We have in the past and may in the future need to issue corrective releases of our software products to fix these defects or errors. For example, we issued corrective releases to fix problems with the version of our PowerMart released in the first quarter of 1998. As a result, we had to allocate significant customer support resources to address these problems.

Our license agreements with our customers typically contain provisions designed to limit our exposure to potential product liability claims. However, the limitation of liability provisions contained in our license agreements may not be effective as a result of existing or future national, federal, state or local laws or ordinances or unfavorable judicial decisions. Although we have not experienced any product liability claims to date, the sale and support of our products entails the risk of such claims, which could be substantial in light of the use of our products in enterprise-wide environments. In addition, our insurance against product liability may not be adequate to cover a potential claim.

Table of Contents

***If we are unable to successfully respond to technological advances and evolving industry standards, we could experience a reduction in our future product sales, which would cause our revenues to decline.***

The market for our products is characterized by continuing technological development, evolving industry standards, changing customer needs and frequent new product introductions and enhancements. The introduction of products by our direct competitors or others embodying new technologies, the emergence of new industry standards or changes in customer requirements could render our existing products obsolete, unmarketable or less competitive. In particular, an industry-wide adoption of uniform open standards across heterogeneous applications could minimize the importance of the integration functionality of our products and materially adversely affect the competitiveness and market acceptance of our products. Our success depends upon our ability to enhance existing products, to respond to changing customer requirements and to develop and introduce in a timely manner new products that keep pace with technological and competitive developments and emerging industry standards. We have in the past experienced delays in releasing new products and product enhancements and may experience similar delays in the future. As a result, in the past, some of our customers deferred purchasing our products until the next upgrade was released. Future delays or problems in the installation or implementation of our new releases may cause customers to forego purchases of our products and purchase those of our competitors instead. Additionally, even if we are able to develop new products and product enhancements, we cannot assure you that they will achieve market acceptance.

***We recognize revenue from specific customers at the time we receive payment for our products, and if these customers do not make timely payment, our revenues could decrease.***

Based on limited credit history, we recognize revenue from direct end users, resellers, distributors and OEMs, which have not been deemed credit-worthy, at the time we receive payment for our products, rather than at the time of sale. If these customers do not make timely payment for our products, our revenues could decrease. If our revenues decrease, the price of our common stock may fall.

***We have a limited operating history and a cumulative net loss, which makes it difficult to evaluate our operations, products and prospects for the future.***

We were incorporated in 1993 and began selling our products in 1996; therefore, we have a limited operating history upon which investors can evaluate our operations, products and prospects. With the exception of 2003 and the first quarter of 2004, where we had net income of $7.3 million and $1.9 million, respectively, since our inception we have incurred significant annual net losses, resulting in an accumulated deficit of $88.8 million as of March 31, 2004. We cannot assure you that we will be able to sustain profitability in the future. If we are unable to sustain profitability, we may fail to meet the expectations of stock analysts and investors, and the price of our common stock may fall.

***Our international operations expose us to greater intellectual property, collections, exchange rate fluctuations, regulatory and other risks, which could limit our future growth.***

We have significant operations outside the United States, including software development centers in India, the Netherlands and the United Kingdom, sales offices in Belgium, Canada, France, Germany, the Netherlands, Switzerland and the United Kingdom, and customer support centers in the Netherlands and the United Kingdom. Our international operations face numerous risks. For example, in order to sell our products in certain foreign countries, our products must be localized, that is, customized to meet local user needs. Developing local versions of our products for foreign markets is difficult, requires us to incur additional expenses and can take longer than we anticipate. We currently have limited experience in localizing products and in testing whether these localized products will be accepted in the targeted countries. We cannot assure you that our localization efforts will be successful.

In addition, we have only a limited history of marketing, selling and supporting our products and services internationally. As a result, we must hire and train experienced personnel to staff and manage our foreign operations. However, we have experienced difficulties in recruiting, training and managing an international staff, and we may continue to experience such difficulties in the future.

We must also be able to enter into strategic distributor relationships with companies in certain international markets where we do not have a local presence. If we are not able to maintain successful strategic distributor relationships internationally or recruit additional companies to enter into strategic distributor relationships, our future success in these international markets could be limited.

Our software development centers in India, the Netherlands and the United Kingdom also subject our business to certain risks, including:

- greater difficulty in protecting our ownership rights to intellectual property developed in foreign countries, which may have laws that materially differ from those in the United States;
- communication delays between our main development center in Redwood Shores, California and our development centers in India, the Netherlands and the United Kingdom as a result of time zone differences, which may delay the development, testing or release of new products;
- greater difficulty in relocating existing trained development personnel and recruiting local experienced personnel, and the costs and expenses associated with such activities; and
- increased expenses incurred in establishing and maintaining office space and equipment for the development centers.

Additionally, our international operations as a whole are subject to a number of risks, including the following:

- greater risk of uncollectible accounts and longer collection cycles;
- greater risk of unexpected changes in regulatory practices, tariffs, and tax laws and treaties;
- fluctuations in exchange rates between the U.S. dollar and foreign currencies in markets where we do business because we do not engage in any hedging activities; and
- general economic and political conditions in these foreign markets.

These factors and other factors could harm our ability to gain future international revenues and, consequently, materially impact our business, results of operations and financial condition. Our failure to manage our international operations and the associated risks effectively could limit the future growth of our business. The expansion of our existing international operations and entry into additional international markets will require significant management attention and financial resources.

***If we are not able to adequately protect our proprietary rights, third parties could develop and market products that are equivalent to our own, which would harm our sales efforts.***

Our success depends upon our proprietary technology. We believe that our product developments, product enhancements, name recognition and the technological and innovative skills of our personnel are essential to establishing and maintaining a technology leadership position. We rely on a combination of patent, copyright, trademark and trade secret rights, confidentiality procedures and licensing arrangements to establish and protect our proprietary rights.

However, these legal rights and contractual agreements may provide only limited protection. Our pending patent applications may not be allowed or our competitors may successfully challenge the validity or scope of any of our six issued patents or any future issued patents. Our patents alone may not provide us with any significant competitive advantage, and third parties may develop technologies that are similar or superior to our technology or design around our patents. Third parties could copy or otherwise obtain and use our products or technology without authorization, or develop similar technology independently. We cannot easily monitor any unauthorized use of our products, and, although we are unable to determine the extent to which piracy of our software products exists, software piracy is a prevalent problem in our industry in general.

The risk of not adequately protecting our proprietary technology and our exposure to competitive pressures may be increased if a competitor should resort to unlawful means in competing against us. For example, in July 2003 we settled a complaint against Ascential Software Corporation in which a number of

Table of Contents

former Informatica employees recruited and hired by Ascential, misappropriated our trade secrets, including sensitive products and marketing information and detailed sales information regarding existing and potential customers and unlawfully used that information to benefit Ascential in gaining a competitive advantage against us. Although we were ultimately successful in this lawsuit, there are no assurances that we will be successful in protecting our proprietary technology from competitors in the future.

We have entered into agreements with many of our customers and partners that require us to place the source code of our products into escrow. Such agreements generally provide that such parties will have a limited, non-exclusive right to use such code if: (1) there is a bankruptcy proceeding by or against us; (2) we cease to do business; or (3) we fail to meet our support obligations. Although our agreements with these third parties limit the scope of rights to use of the source code, we may be unable to effectively control such third-party s actions.

Furthermore, effective protection of intellectual property rights is unavailable or limited in various foreign countries. The protection of our proprietary rights may be inadequate and our competitors could independently develop similar technology, duplicate our products or design around any patents or other intellectual property rights we hold.

We may be forced to initiate litigation in order to protect our proprietary rights. For example, on July 15, 2002, we filed a patent infringement lawsuit against Acta Technology, Inc. Although this lawsuit is in the early stages, litigating claims related to the enforcement of proprietary rights can be very expensive and can be burdensome in terms of management time and resources, which could adversely affect our business and operating results.

***We may face intellectual property infringement claims that could be costly to defend and result in our loss of significant rights.***

As is common in the software industry, we have received and may continue from time to time to receive notices from third parties claiming infringement by our products of third-party patent and other proprietary rights. Third parties could claim that our current or future products infringe their patent or other proprietary rights. As the number of software products in our target markets increases and the functionality of these products further overlaps, we may become increasingly subject to claims by a third party that our technology infringes such party s proprietary rights. Any claims, with or without merit, could be time-consuming, result in costly litigation, cause product shipment delays or require us to enter into royalty or licensing agreements, any of which could adversely affect our business, financial condition and operating results. Although we do not believe that we are currently infringing any proprietary rights of others, legal action claiming patent infringement could be commenced against us, and we may not prevail in such litigation given the complex technical issues and inherent uncertainties in patent litigation. The potential effects on our business that may result from a third-party infringement claim include the following:

- we may be forced to enter into royalty or licensing agreements, which may not be available on terms acceptable to us, or at all;
- we may be required to indemnify our customers or obtain replacement products or functionality for our customers;
- we may be forced to significantly increase our development efforts and resources to redesign our products as a result of these claims; and
- we may be forced to discontinue the sale of some or all of our products.

***We may engage in future acquisitions or investments that could dilute our existing stockholders, or cause us to incur contingent liabilities, debt or significant expense.***

From time to time, in the ordinary course of business, we may evaluate potential acquisitions of, or investments in, related businesses, products or technologies. For example, we recently acquired Striva in September 2003, and we invested $500,000 in a private company that is still in the development stage of its

Table of Contents

business cycle. Future acquisitions and investments like these could result in the issuance of dilutive equity securities, the incurrence of debt or contingent liabilities, or the payment of cash to purchase equity securities from third parties. There can be no assurance that any strategic acquisition or investment, including Striva, will succeed.

***Delaware law, as well as our certificate of incorporation and bylaws, contains provisions that could deter potential acquisition bids, which may adversely affect the market price of our common stock, discourage merger offers and prevent changes in our management or Board of Directors.***

Our basic corporate documents and Delaware law contain provisions that might discourage, delay or prevent a change in the control of Informatica or a change in our management. In addition, we have adopted a stockholder rights plan. Under the plan, we issued a dividend of one right for each outstanding share of common stock to stockholders of record as of November 12, 2001, and such rights will become exercisable only upon the occurrence of certain events. Because the rights may substantially dilute the stock ownership of a person or group attempting to take us over without the approval of our Board of Directors, the plan could make it more difficult for a third party to acquire us or a significant percentage of our outstanding capital stock without first negotiating with our Board of Directors regarding such acquisition.

Our bylaws provide that we have a classified Board of Directors, with each class of directors subject to re-election every three years. This classified board has the effect of making it more difficult for third parties to insert their representatives on our Board of Directors and gain control of Informatica. These provisions could also discourage proxy contests and make it more difficult for our stockholders to elect directors and take other corporate actions. The existence of these provisions could limit the price that investors might be willing to pay in the future for shares of our common stock.

***We may need to raise additional capital in the future, which may not be available on reasonable terms to us, if at all.***

We may not generate sufficient revenue from operations to offset our operating or other expenses. As a result, in the future, we may need to raise additional funds through public or private debt or equity financings. We may not be able to borrow money or sell more of our equity securities to meet our cash needs. Even if we are able to do so, it may not be on terms that are favorable or reasonable to us. If we are not able to raise additional capital when we need it in the future, our business could be seriously harmed.

***Business interruptions could adversely affect our business.***

Our operations are vulnerable to interruption by fire, earthquake, power loss, telecommunications failure and other events beyond our control. We do not have a detailed disaster recovery plan. Our facilities in the State of California are currently subject to electrical blackouts as a consequence of a shortage of available electrical power, which occurred during 2001. In the event these blackouts are reinstated, they could disrupt the operations of our affected facilities. In connection with the shortage of available power, prices for electricity may continue to increase in the foreseeable future. Such price changes will increase our operating costs, which could negatively impact our profitability. In addition, we do not carry sufficient business interruption insurance to compensate us for losses that may occur, and any losses or damages incurred by us could have a material adverse effect on our business.

**Item 3.** ***Quantitative and Qualitative Disclosures About Market Risk***

**Interest Rate Risk**

Our exposure to market risk for changes in interest rates relates primarily to our investment portfolio. We do not use derivative financial instruments in our investment portfolio. The primary objective of our investment activities is to preserve principal while maximizing yields without significantly increasing risk. Our investment policy specifies credit quality standards for our investments and limits the amount of credit exposure to any single issue, issuer or type of investment. Our investments consist primarily of commercial

Table of Contents

paper, U.S. government notes and bonds, corporate bonds and municipal securities. All investments are carried at market value, which approximates cost.

As of March 31, 2004, the average rate of return on our investments was 1.5%. If market interest rates were to increase immediately and uniformly by 100 basis points from levels as of March 31, 2004, the fair market value of the portfolio would decline by approximately $1.0 million. Declines in interest rates will, over time, reduce our interest income.

**Foreign Currency Risk**

We market and sell our software and services through our direct sales force and indirect channel partners in the United States as well as Belgium, Canada, France, Germany, the Netherlands, Switzerland and the United Kingdom. We also have relationships with indirect channel partners in various other regions, including Asia-Pacific, Australia, Europe, Japan and Latin America. As a result, our financial results could be affected by factors such as changes in foreign currency exchange rates or weak economic conditions in foreign markets. As our sales are primarily in U.S. dollars, a strengthening of the dollar could make our products less competitive in foreign markets. We translate foreign currencies into U.S. dollars for reporting purposes and currency fluctuations may have a quarterly impact on our financial results. To date, we have not engaged in any foreign currency hedging activities.

**Item 4.** ***Controls and Procedures***

*Evaluation of disclosure controls and procedures.* Our management evaluated, with the participation of our Chief Executive Officer and our Chief Financial Officer, the effectiveness of our disclosure controls and procedures as of the end of the period covered by this Quarterly Report on Form 10-Q. Based on this evaluation, our Chief Executive Officer and our Chief Financial Officer have concluded that our disclosure controls and procedures are effective to ensure that information we are required to disclose in reports that we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms.

*Changes in internal control over financial reporting.* There was no change in our internal control over financial reporting that occurred during the period covered by this Quarterly Report on Form 10-Q that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents

## PART II. OTHER INFORMATION

**Item 1.** ***Legal Proceedings***

On November 8, 2001, a purported securities class action complaint was filed in the United States District Court for the Southern District of New York. The case is entitled In re Informatica Corporation Initial Public Offering Securities Litigation, Civ. No. 01-9922 (SAS) (S.D.N.Y.), related to In re Initial Public Offering Securities Litigation, 21 MC 92 (SAS) (S.D.N.Y.). Plaintiffs amended complaint was brought purportedly on behalf of all persons who purchased our common stock from April 29, 1999 through December 6, 2000. It names as defendants Informatica Corporation, one of our current officers, and one of our former officers (the Informatica defendants ), and several investment banking firms that served as underwriters of our April 29, 1999 initial public offering and September 28, 2000 follow-on public offering. The complaint alleges liability as to all defendants under Sections 11 and/or 15 of the Securities Act of 1933 and Sections 10(b) and/or 20(a) of the Securities Exchange Act of 1934, on the grounds that the registration statements for the offerings did not disclose that: (1) the underwriters had agreed to allow certain customers to purchase shares in the offerings in exchange for excess commissions paid to the underwriters; and (2) the underwriters had arranged for certain customers to purchase additional shares in the aftermarket at predetermined prices. The complaint also alleges that false analyst reports were issued. No specific damages are claimed.

Similar allegations were made in other lawsuits challenging over 300 other initial public offerings and follow-on offerings conducted in 1999 and 2000. The cases were consolidated for pretrial purposes. On February 19, 2003, the Court ruled on all defendants motions to dismiss. The Court denied the motions to dismiss the claims under the Securities Act of 1933. The Court denied the motion to dismiss the Section 10(a) claim against Informatica and 184 other issuer defendants. The Court denied the motion to dismiss the Section 10(a) and 20(a) claims against the Informatica defendants and 62 other individual defendants.

We have decided to accept a settlement proposal presented to all issuer defendants. In this settlement, plaintiffs will dismiss and release all claims against the Informatica defendants, in exchange for a contingent payment by the insurance companies collectively responsible for insuring the issuers in all of the IPO cases, and for the assignment or surrender of control of certain claims we may have against the underwriters. The Informatica defendants will not be required to make any cash payments in the settlement, unless the pro rata amount paid by the insurers in the settlement exceeds the amount of the insurance coverage, a circumstance which we do not believe will occur. The settlement will require approval of the Court, which cannot be assured, after class members are given the opportunity to object to the settlement or opt out of the settlement.

On July 15, 2002, we filed a patent infringement action in U.S. District Court in Northern California against Acta Technology, Inc. Acta ), now known as Business Objects Data Integration, Inc. ( BODI ), asserting that certain Acta products infringe on three of our patents: U.S. Patent No. 6,014,670, entitled Apparatus and Method for Performing Data Transformations in Data Warehousing ; U.S. Patent No. 6,339,775, entitled Apparatus and Method for Performing Data Transformations in Data Warehousing (this patent is a continuation-in-part of and claims the benefit of U.S. Patent No. 6,014,670); and U.S. Patent No. 6,208,990, entitled Method and Architecture for Automated Optimization of ETL Throughput in Data Warehousing Applications. On July 17, 2002, we filed an amended complaint alleging that Acta products also infringe on one additional patent: U.S. Patent No. 6,044,374, entitled Object References for Sharing Metadata in Data Marts. In the suit, we are seeking an injunction against future sales of the infringing Acta/ BODI products, as well as damages for past sales of the infringing products. We have asserted that BODI s infringement of the Informatica patents was willful and deliberate. On September 5, 2002, BODI answered the complaint and filed counterclaims against us seeking a declaration that each patent asserted is not infringed and is invalid and unenforceable. BODI did not make any claims for monetary relief against us. The parties presented their respective claim constructions to the Court on September 24, 2003 and are awaiting the Court s ruling. The matter is currently in the discovery phase.

Table of Contents

We are also a party to various legal proceedings and claims, either asserted or unasserted, arising from the normal course of business activities.

In management s opinion, resolution of any of these matters is not expected to have a material adverse impact on our results of operations, cash flows or its financial position. However, depending on the amount and timing, an unfavorable resolution of these matters could materially and adversely affect our future results of operations, cash flows or financial position in a future period.

**Item 6.** ***Exhibits and Reports on Form 8-K***

**(a)** *Exhibits*

| Exhibit | |
|---|---|
| 31.1 | Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 31.2 | Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 32.1 | Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |

**(b)** *Reports on Form 8-K*

During the three months ended March 31, 2004, we filed the following Current Report on Form 8-K:

We filed a Form 8-K on January 21, 2004 under Item 12. Results of Operations and Financial Condition furnishing our press release reporting our results of operations for the three months and year ended December 31, 2003.

We filed a Form 8-K on February 23, 2004 under Item 12. Results of Operations and Financial Condition furnishing our press release reporting that we would be adjusting our previously announced 2003 quarterly revenues to correct an error in the allocation of revenues between license and service components.

**Items 2, 3, 4 and 5 are not applicable and have been omitted.**

Table of Contents

## SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, Informatica Corporation has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

INFORMATICA CORPORATION

By: /s/ EARL E. FRY

Earl E. Fry
*Chief Financial Officer*
*(Duly Authorized Officer and*
*Principal Financial and Accounting Officer)*

Dated: May 6, 2004

**EXHIBIT INDEX**

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